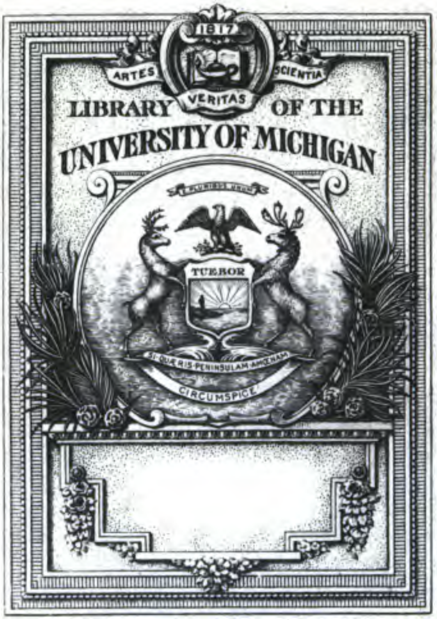
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CHAPTER I

THE BAR TO PROSPERITY

HAVE you ever had a door slammed in your face? If so, surprise was your first emotion, no doubt, then astonishment that such an unexpected thing should happen. This feeling probably gave way to one of anger, of resentment at being so uncivilly treated. Especially would such an occurrence irritate you if the weather were cold and your overcoat were behind the door.

After a while a question would probably spring up. Who slammed the door? Why was it done? There was no one you could think of who might have a reason for closing the door against you. Perhaps it was done unintentionally. Or, perhaps it was the wind that slammed the door.

Suppose this door were the door to success and prosperity! Would it not be interesting to know what closed it and why it was closed? And would it not be much more interesting to know how to open it and how to keep it from being closed?

Well that is just what we are talking about—the door to prosperity. And our object is to answer both these questions. First we must see clearly what shuts the door and then we can devise a means for keeping it open. It will be shown that success and prosperity can be made accessible to all at all times.

Of the several millions of business men who have had occasion to seek a loan from a bank, it is likely that a large majority have had the bank door slammed in their faces at some time or other during their career.

The time generally comes to most business men when they need more cash; and to get it they naturally go to the logical place—the bank. Perhaps you have been there and offered to put up maybe three or four to one in security for a loan.

After explaining the plan and showing the security you are fortunate if you have never received from the banker the following answer: "Your securities are good, and your enterprise is a worthy one. We will admit it is a success and we would like to help you by making this loan, but YOUR SECURITIES ARE NOT BANKABLE."

If you have received this answer you were perhaps angered and applied at another bank. Probably the same answer was received from the next banker, and the next, although you sought to make the loan more attractive each time by increasing the bonus or security offered.

If you are a merchant or broker, and have never attempted to borrow except upon self-liquidating security, you may not have had an experience comparable to this; but, if you are a manufacturer or producer of any kind—and especially a farmer desirous of extending your enterprise—you will certainly recognize the above answer as a set formula.

But it may be that you are not engaged in business and that you have never tried to borrow money from a

bank and that you never expect to. So, you may think, bank loans do not concern you.

It will soon appear, however, that we are all interested in every bank loan for the bank door is the door to prosperity.

Real prosperity is not the piling up of wealth by a few, but the giving of the best to the majority with the least effort on the part of the individual—it is the satisfaction of the community's wants as completely as possible at the lowest cost. This needs no argument.

Now, in the above example where the loan was refused by the bank, it has been admitted by all that the enterprise is a good one. The bankers all said: "Your enterprise is a worthy one." In other words, it is one which would result in more efficient production—in the end it would lead to a more complete satisfaction of society's wants at a lower cost. It would lead to greater prosperity. And the one thing that was still necessary to the success of this enterprise was a loan from the bank. The loan was refused although the security was good. The enterprise could not be carried out because a good security was not bankable. The only conclusion is that the banker acted as a hindrance to prosperity.

It seems then that something is wrong, and that this something is concerned with the bank. But do not proceed at once to blame everything upon the banker. Remember, it may have been the wind that slammed the door.

Let us proceed further, and see if there is anything more to be noted which will show us where the fault is.

Since the farmer is one of the most important mem-

bers of our industrial organization, food being the first of our necessities, and it being the farmer's business to supply it, let us take his case.

When the farmer is in need of a loan, and applies for it at the bank, what happens? He is willing to give perfectly good security—a mortgage on his farm. The loan is nevertheless refused, because the security, while good, is not bankable.

Unable to get the necessary facilities for carrying on business the farmer cannot carry out his projected improvement, and society suffers from a lesser degree of prosperity than would otherwise have been possible.

An effort was made to assist the farmer through the adoption of the Farm Loan Act in 1916. Without entering extensively into this matter, it will be sufficient at this point to say that this act was of some assistance. It provided a cumbersome means by which the farmer could obtain some of the capital necessary for permanent improvements. But while it did some good, it was at best very deficient. And furthermore, the passing of a special law to give financial relief to the farmer is in itself a confession that the banking system, the ordinary means of supplying credit, is inadequate.

That the Farm Loan Act did not overcome the inadequacy of the banking system as regards the farmer is proved by the fact that Congress has recently reinstated the War Financing Corporation.

This institution was erected during the war for the purpose of financing industry made necessary by war but now it has been rehabilitated as another means of taking care of the farmer's financial needs. It will not

do the work required of it for it cannot reach the "sore spot" as will presently be shown.

When the exporter's troubles began to get on our industrial nerves Congress passed what is known as the Edge Act as an amendment to the Federal Reserve Act. Under this law a large group of bankers is now attempting to form a Foreign Trade Financing Corporation with the hope of reviving our drooping export and shipping business. There is no hesitancy in saying that even if they succeed in putting it together it will not solve the problem. In fact its influence will hardly be noticeable. The reason for this statement will appear in the chapter on "Foreign Exchange."

All these various acts and the Federal Reserve Act itself, as it stands today, are but patches on a financial system that can be made practically perfect by a small dose of American common sense properly administered.

What is necessary and how to do it in order to set the wheels of industry humming and restore prosperity will be clearly shown as we progress.

The case of automobile dealers at the present time is another example that is to the point. The Federal Reserve bank will rediscount no "automobile paper" except that based on machines used for commercial purposes. All other dealers are, as a result, unable to obtain the facilities to carry on business for the banks will not discount paper secured by their stock-in-trade of automobiles.

Here is another instance in which our present banking system is not only inadequate but works a very great hardship. It is another instance in which the banks fail

to supply all the needs of the community which they should satisfy. Automobiles are today a recognized need of the community. The automobile dealer is, therefore, a necessary factor in our commercial organization. But these dealers cannot obtain the commercial facilities they need in order to carry on business.

The present selling plan for automobiles, where the dealer takes a cash payment of about a third of the price and the balance in notes running from ten to twelve months, was built up through the cooperation of the banks. The banks were glad to discount this paper especially after the automobile dealers had gotten insurance companies to insure the automobile against theft, fire and embezzlement.

It took several years and much thought and energy on the part of the automobile trade to build up this selling plan and to educate the public to use it. All the dealers' calculations were based on this selling plan and the factory depended upon it for its funds.

Unless the banker continues to discount this paper the dealer cannot pay the manufacturer for his goods except he cashes his paper by paying excessive discount to private parties, and the manufacturer is not in a position to wait for payment until the cars are paid for in full by the purchaser.

Here we have the proper scope for the functions of the bank—to lend money upon good security. The security offered is the stock-in-trade itself—the automobiles. Such security has proved to be good but the bank will not or cannot carry the paper and the community suffers.

No one, calling to mind our present industrial turmoil, business uncertainty, and social unrest, will be disposed to doubt that a wrong exists. It also seems quite clear that this wrong is intimately concerned with our banking system. It cannot be denied that there is a flaw in a system which refuses the farmer a loan because his security is one of property. It is also clear that a system which disrupts the second largest business in the country—the automobile trade—without warning and with very harmful results is dangerous and inefficient. The present state of our foreign trade and shipping business is another glaring example. But before proceeding further in our search of the flaw, let us consider the commonly accepted explanation of present bad conditions.

As usual, laborers are blaming the capitalists, and capitalists the laborers, although neither party is very sure of what the other is, nor why it is responsible for present bad conditions.

The manufacturers and jobbers are complaining of a "Buyers Strike," the financiers say the trouble is due to "Frozen Credits," the economists tell us "Liquidation" must take place before prosperity returns, and the press says we must get back to "Normalcy."

These high sounding phrases, at present popular with financial writers, will be explained later but first let us examine what is, or rather was, given as the most popular explanation for bad conditions.

For a year or so after the close of the war the common disturber of the peace and happiness of the country

was said to be the "High Cost of Living." Everything that was wrong was due to the "H. C. L."

This "High Cost of Living" is another catchy phrase. It seems to invite and hold hostility, like the word "witch," or "hobgoblin," and like those words, it has no exact meaning. Another good thing about all such terms is that they do not accuse anyone in particular of wrong-doing, so they are convenient for our statesmen and other economic doctors to use in describing a pathologic condition of the social organism.

In the recent campaign against the "High Cost of Living," it became generally accepted that the H. C. L. was the result of a large group of men doing business at a profit, and who consequently were known as "profiteers." This group was so large and scattered that it took in a good percentage of the people of the United States. But the politicians had to make a pretence of hurting some of the big fellows, in order to appease the public; so five packers of Chicago were chosen, by common consent, to be the object of Congressional investigation. While this action may not seem entirely fair to the packers, no sympathy need be wasted on them, for they were not greatly hurt.

In spite of all this campaigning there was no break in the price of commodities. The High Cost of Living remained until the banks decided it was time to "deflate," that is, shut the door. This action brought down some prices in a hurry and is now bringing down wages so it is not giving general satisfaction. It has also caused business stagnation and unemployment with a decrease in bank clearings and an increase in business failures,

so the lowering of prices has aggravated rather than solved the problem.

Although no one has a very clear idea of what the term "High Cost of Living" means, everyone will say that it has something to do with high prices. The retailer says he has to charge high prices because of high expenses, and because of high prices charged him by the manufacturer. The manufacturer says he has to charge high wholesale prices because of the high wages he has to pay and because of the high cost of raw material and everything else he has to buy.

In general, then, the social and commercial disturbance and unrest is blamed upon high prices, as being the cause of the high cost of living.

During President Cleveland's second administration, back in the '90s, there was no complaint about high prices. Corn was so cheap it was being used as fuel. Eggs could be bought for ten cents per dozen. Clothing and shoes were about one half of their present price. However, there was great business depression and a similar amount and degree of social unrest. At that time conditions were the reverse of what they are now or were recently. When the H. C. L. was the topic of the day wages were high, there was a job for everybody, who wanted one, business was good and high prices prevailed. During Cleveland's time when prices were low, we had starvation wages, unemployment, business failures, soup kitchens, Coxey armies and panic. And as a result, what we recently blamed upon the High Cost of Living, was then blamed upon the Low Cost of Living.

Just as conditions during the '90s were the reverse of

what they were when the H. C. L. was the great bugaboo, so the remedies proposed then were the reverse of those proposed to overcome the H. C. L.

It will be remembered that Mr. Bryan made a presidential campaign in 1896 on a platform that declared for the free and unlimited coinage of silver at the ratio of sixteen to one. The argument was that the price of wheat followed the price of silver, and as the price of wheat was the barometer of all prices the way to raise prices was to restore the price of silver to $1.29 per ounce. Raising the price of silver would raise the price of wheat correspondingly, and all prices would follow the upward trend.

In other words, prices then were low, and the remedy proposed was one designed to raise prices. When prices were high, it was almost universally believed that the only efficacious remedy was to lower prices.

The theory when Bryan ran for president the first time was that a low price for commodities caused low wages and business stagnation, which was an economic calamity to be avoided, and the remedy suggested was to raise prices.

The theory during the extreme high price period seemed to be that high prices, with their accompanying effects of good wages, plenty of work, profitable business and a high standard of living produced a bad economic condition which should have been remedied by lowering prices through government regulation or by deflation.

If the H. C. L. were the cause of industrial turmoil our condition now should be most serene for many prices have recently taken a violent fall. This fall in prices,

however, does not seem to be giving satisfaction. The agricultural interests are making continuous efforts to secure credit for the purpose of holding their crops for higher prices. They have pleaded with the banks, the Federal Reserve Board and the President for help. They asked that the war time Government financing corporation be reinstated to save them from financial ruin. They are now forming marketing associations and the bankers are trying to form foreign trade corporations under the "Edge Act" with the avowed purpose of raising prices. The situation makes the argument that our economic condition is due to prices ridiculous.

It is illogical to blame at one time the High Cost, and at another the Low Cost of Living, for the same results, and to suggest identically opposite remedies.

And, as a matter of fact, if we compare our conditions under high prices, with those that existed a few years back under low prices, we are forced to admit that the majority were really better off under high prices than when prices were low. Never was there a time when the majority of the people enjoyed so many comforts and luxuries with so little expenditure of time and effort as they did when prices were the highest. Things which the most humble citizen of today regards as necessities were but a few years ago regarded either as the greatest of luxuries, or else were unobtainable. Present living and working conditions are so improved for the majority of the people that it is hard to realize that the old adage: "Man works from sun to sun, but a woman's work is never done" expressed the literal truth as to conditions existing only a short time ago.

On the other hand, if we compare the prices current today with those current a few years ago, we must admit that they are much higher now. And if we compare them with those of some time ago, we shall see that they have gone up tremendously.

This condition and the fact that both in the case of the Low Cost of Living and of the High Cost of Living the remedies proposed were concerned with alterations in prices, all point to the same solution. The trouble seems to be in the dollars themselves, and not in the living. If prices remained at a constant level, whether that level were low or high, wages and prices would adjust themselves. For prices are nothing more than the exchange ratios of all commodities and services, expressed in terms of money. Any disturbance of these ratios leads to a need for readjustment, and it is the friction incident to this readjustment that is the real cause of our troubles.

Let us see how this works out in regard to conditions we have experienced.

The war caused a pressing demand for large quantities of various commodities at a time when a great number of men were withdrawn from productive pursuits. The demand for labor increased at a time when the supply of labor had been decreased. This condition caused wages to go up. High wages in "war-industries," drew labor from other industries, thus lessening the supply, and tending to raise wages in these industries too. As a result, there was a twofold tendency to raise prices: in the first place, higher prices had to be charged in order to make it possible to pay the increased

wages; and in the second place, the workers were able to buy more with their increased wages—their effective demand increased, resulting in better business and higher prices.

At the same time large quantities of credit were issued in this and in other countries in order to pay for the goods made necessary by the war. The effect of these new issues of credit was to "inflate" the medium of exchange—there were now more dollars in circulation; in consequence of which the "price of the dollar," that is, the amount of other commodities one dollar would exchange for, decreased. Prices rose.

The war, therefore, had a twofold effect in raising prices, and the result was consequently doubly great. As a result, there was all the more friction in the attempted readjustment, and it is the lack of adjustment that is the cause of our present troubles.

If every exchangeable ratio moved simultaneously and to an equal extent—that is, if prices, wages, interest, profits, and rents rose and fell equally, there would be no such trouble. But they do not; nor is the readjustment equal in all branches of our social organization. Those who produced the commodities, and those who rendered the services which were not directly affected by the demands of war—the public service corporations, landlords, preachers, teachers, actors, and government employees—all were losers by the rise in prices at first because the readjustment of income to expenses was slower in their cases.

Such are the troubles of inflation of the currency, the troubles of the High Cost of Living. The troubles

of the Low Cost of Living are concerned with contraction of the currency. Both inflation and contraction change the purchasing power of money and therefore effect prices. More definitely, they are concerned with the varying price of the dollar—or the changing value of the dollar. The only way to remove these troubles is to make the dollar a constant measurement of value—to have a medium of exchange that can neither be inflated nor contracted.

An illustration will make this clear. Suppose the length of a foot-rule were to vary with the supply of and demand for wood. What havoc would be caused in all our dealings! Luckily a foot is always twelve inches, whatever the price of wood, for it is the same whether measured by a foot-rule of wood, steel, or tape. Similarly if a dollar were always the same, whether measured in gold, silver, wheat, or any other commodity, the greatest of our social evils would disappear.

The problem, then, is not to meddle with the High Cost of Living, nor with the Low Cost of Living, but to remove industrial and social friction by removing their cause. This cause is the varying price of the dollar, and is due to a defect in our monetary system.

The purpose of this somewhat extensive digression, now becomes clear. In the earlier pages of this chapter it was demonstrated that the fullest development of prosperity was prevented by some flaw in our banking system. In the latter half it has been shown that the great social and industrial unrest that is continually making itself felt is due to a flaw in our monetary system. It follows, then, that all these troubles can be

removed by correcting these flaws. The purpose of this book is to show definitely where these flaws are, and to suggest a practical way of removing them.

It is clear that this task would be simplified if it could be shown that both these flaws are really one: that they are results from the same causes, and can be corrected by the same remedy.

As a matter of fact, this is the case. It is a common belief that banks are largely, if not altogether, concerned with money. This idea may require revision, but if it can be proved that the banks are in entire control of the medium of exchange, then it will follow that the flaw in our monetary system is a part of the flaw in our banking system, and that to correct the latter will correct the former.

Before showing where the flaw is, therefore, we will see how both faults are inextricably bound up with each other, so that both problems are really one.

The first step then is to show that the banks have sole control over our medium of exchange—and this will be the purpose of the next chapter.

CHAPTER II

EVOLUTION OF OUR EXCHANGE SYSTEM

BEFORE we go further in our search for a solution of our problem let us by a glance at world conditions today note the need for a solution.

In Europe we find unemployment and want in practically every country. In Asia want extends to starvation for thousands, even millions of people.

In the United States warehouses are filled with wheat, other food products, cotton, wool, copper and practically everything the rest of the world wants. And yet business lags and labor is unemployed.

Consider these facts and ask yourself: "What is the trouble?"

Europe and Asia are suffering from a lack of supply while our business slump is due to a lack of demand. There is plenty of desire for what we have to sell but not much demand.

The rest of the world want to buy our goods and we want to sell them. Our harbors are filled with ships falling to decay for want of a cargo. Our railroads are seeking to cut wages because of lack of business due to a falling off in freight.

With our warehouses full, with plenty of transportation facilities, with people all over the world crying, even dying, for what we have for sale, why do we not sell, revive business and bring back prosperity? WHY?

That is the question we must answer. And it must be a practical common sense answer that can be put into effect, so as to overcome these conditions and bring peace and prosperity to a troubled world.

The trouble is plainly in our exchange system. It has broken down. The means by which we carry on business, our financial system, is at fault. It is inadequate to facilitate the exchange which makes business possible so the whole world suffers.

A few cases wherein our present system fails to supply the needs of business such as that of the farmer and others have been pointed out. In this and the following three chapters the reasons for this failure will be shown and in chapters VII and VIII a simple way of overcoming the trouble will be given.

Now that we recognize that our prosperity and the reconstruction of the world depend on a correct solution of this exchange problem we can proceed.

As was stated in the last chapter, the next step in solving the problem before us is to show that all the evils resulting from the varying price of the dollar, and all the hindrances to progress resulting from lack of credit facilities are due to some defect in our banking system. Also that both these defects owe their origin to one and the same cause.

In the one case we saw that the evils were due to a defect in the monetary system, and in the other case to a defect in the banking system. If it can be shown that our circulating medium—our money—is entirely in the control of our bankers, it will follow that the evils are all due to the same cause.

In order to do this we must have a clear idea of what our monetary system is, so it will be necessary first to touch upon the more important phases in the history of the development of money.

Primitive exchange, it is easy to see, proceeded by means of barter. One man would exchange that which he had directly for that which he wanted. But this method had great disadvantages. For instance, one might find that the man who owned that which he desired did not wish to exchange it for that which he had to offer. Suppose one man had a bear-skin, which he wished to exchange for food. Another man might have some surplus food, but he might not want a bear-skin. And even if he did desire a bear-skin, he might not have enough food to exchange for one. Or the man with the bear-skin might desire only half a bear-skin's worth of food, desiring in addition something else which the other man did not possess. Such an example, crude as it is, serves to indicate some of the great difficulties of barter.

Sometimes, however, a man would be willing to take in exchange for something he had, some object which he did not want himself, but which he could be sure some one else would want. This was the first step taken in the development of a medium of exchange. For instance, the man would be willing to take the bear-skin in exchange for his food, if he could be practically certain that some one else would want such a skin, and would give in exchange for it something which its possessor wanted more than he wanted the skin.

Naturally those things which were most in demand

came to be accepted most readily. Shells, teeth, and other articles prized for ornamental purposes would pass from hand to hand in exchange for things that were desired more urgently. Even more perishable commodities have been used in this way, such as dried fish and tobacco—but obviously these could not remain in circulation very long. Consequently the more lasting articles took the place of the more perishable as a medium of exchange.

From this situation it is easy to understand how the metals, on account of their durability, and the more precious metals especially, on account of the convenience in carrying them, came to be used almost exclusively in acts of exchange. Gold and silver came to be used universally to carry on trade. A subsequent development was the process of coining, by which certain weights of these metals were struck with a stamp to signify their weight and fineness.

Since everybody was willing to accept gold or silver in return for goods, gold and silver became the most convenient "storehouses of value." Whoever had more goods than he needed, would exchange the surplus for gold or silver and the metal being non-perishable and always acceptable could be put by against a time when he would need other goods for which he could exchange the metals. And in order to guard against theft, he would look around for the safest place to keep them.

Goldsmiths, since they worked in the precious metals, always had to have a supply of gold and silver on hand, so they had strong-boxes in which to store them safely. It became a custom for them to oblige their patrons by

also storing the gold of these patrons. In return for the metal deposited with them they would give a receipt.

Since gold could be had to the amount called for upon presentation of these receipts, people came to look upon them as being as valuable as the metal itself. The goldsmith was trustee for the gold which gave the receipts their value, and so people began to transfer them or came to use these receipts as money instead of the metal. Since gold could be had in exchange for them for the asking, people were ready to accept these receipts the same as gold in return for their wares. They were even more acceptable, sometimes, on account of the greater ease of handling, consequently the gold itself was seldom demanded.

Meanwhile the goldsmith, finding that no one came to ask for the gold which had been deposited, or at any rate, that very few did, began to issue receipts against which no gold had been deposited. People would accept these receipts as willingly as those for which gold had been deposited, for they did not know the difference. And so long as the goldsmith could pay metal in exchange for all receipts that might be tendered, so long it did not matter whether there was a full amount of gold behind the notes or not. The only thing the goldsmith had to do in order to keep his receipts passing as money was to keep people thinking that there was gold behind them, and this he could do so long as he was able to pay gold on demand.

The very same principle is behind all our issues of paper money today. As long as people are confident that they can get value in return for paper money, they

will accept the paper as readily as gold, and in some cases even more readily. And a similar principle lies at the bottom of our bank check system. If only people are confident that they will be able to get money in payment of the check, they will be willing to accept the check in return for their wares.

Most people today think that business is carried on by means of money. Some there are, indeed, who think that it is really carried on by means of gold, since the paper money that is used calls for gold, and gold can sometimes be had for it on demand.

But as a matter of fact this is not the case. Bank Credit is almost entirely our medium of exchange. To be more exact, the report of the Comptroller of the Currency of the United States for 1919 shows that we do about 95% of all our business by the use of checks. The report says (Page 36, Vol. 2), that our medium of exchange is made up as follows:

Gold	.60%
Silver	.40%
Paper (all paper money of government issue)	4.90%
Bank Credit (bank deposits transferred by check)	94.10%
	100.00%

This table was made up in 1909 before the Federal Reserve System was established. Since its establishment our paper money consists almost entirely of federal reserve notes and national bank notes, both of which are

in reality bank credit, so our medium of exchange now is more than 99% bank credit.

From the foregoing it is evident that BANK CREDIT, or credit on the bank's books, is practically our sole medium of exchange. Government money consists of change only and is used for the lesser transactions where it would be inconvenient to draw a check, as for instance, to pay for a lunch or car fare.

Since bank credit then is the medium by which trade is conducted and which moves and controls all our industries and through them regulates our lives, it should not only be interesting and profitable, but it is essentially necessary, that we should understand clearly what bank credit is, and how it comes into existence. To do this let us follow the operations of a bank.

After obtaining its charter, our bank begins business with, we will say, a paid up capital of $10,000. The people of the community then deposit gold or other cash to the amount of $50,000. This fifty thousand dollars becomes the property of the bank, subject to the right of withdrawal by the depositor, and the bank statement appears as follows:

RESOURCES		LIABILITIES	
Cash	$60,000	Capital ...	$10,000
		Deposits ..	50,000
	$60,000		$60,000

The banker knows from experience that some of his customers will bring in, on an average, as much money as others draw out, so the sixty thousand dollars in cash

is usually on hand all the time. If his customers would continue to draw out money he would have to close his doors. We will therefore assume that the $60,000 remains constant. From this fact the banker naturally infers, as did his predecessor the goldsmith, that if the bank's ten thousand dollars are accepted by the public as a guarantee for fifty thousand dollars, then the whole sixty thousand dollars in cash will serve as a guarantee for a much larger sum. So the bank begins to "lend money."

In this transaction the regular procedure is as follows. The would-be borrower makes out an application for a loan in which he states the amount desired and the time for which it is wanted. He enumerates the securities he proposes to furnish with his note and states the use he intends to make of the money. The banker hands this list of securities to the bank appraiser for valuation. Accompanied by the appraiser's report, the application then goes before the finance or loan committee of the bank for action. This committee is usually composed of five or more members of the board of directors, who meet at least once a week to pass on applications for loans, especially on those of new borrowers. This committee may accept or reject the loan applied for, or it may allow only a portion of it. Let us say that the report of the bank appraiser is satisfactory and the action of the loan committee favorable, so that a loan of one thousand dollars at six per cent for ninety days is made to the applicant.

The loan is consummated by the bank taking the note of the borrower and his security and writing on the

credit side of his pass book, "$985.00," representing one thousand dollars discounted at six per cent for ninety days. On the debit side of the bank's books appears the entry: "Loans and Discounts, $1,000;" on the credit side "Deposit, $985.00" and "Discount, $15.00." The bank statement now reads:

RESOURCES		LIABILITIES	
Cash	$60,000	Capital	$10,000
Loans and Discounts ...	1,000	Deposits	50,985
		Discount or Profit	15
	$61,000		$61,000

Here it is seen that the loan appears as an asset on one side of the ledger under the head of "Loans and Discounts" (and properly so, because the bank has the borrower's note and security), and on the other side of the account it appears as a liability, being added in with the cash deposits, just as if it were $985.00 in gold that the borrower had deposited. The other fifteen dollars discount or interest is profit to the bank on the transaction. An analysis of this transaction shows that the banker has done exactly what the goldsmith used to do. He has given the borrower a receipt for a deposit of money though no money has been deposited.

The fiction is that the banker has handed the borrower $985.00 in money for his note, payable in ninety days, and the borrower has gone to the receiving teller's window and deposited the money. The result in the bank's records and in the borrower's pass book is

exactly the same as if that had actually been done. Even if the borrower had taken the cash out of the bank and deposited it in some other bank, or after receiving credit for the deposit had withdrawn it and spent the money in the community, it or its equivalent would soon return to the first bank, and the bank's cash and deposits would therefore remain about the same.

Let us suppose the borrower in this case draws a check for the full amount of the loan in favor of some creditor or to pay for goods. The loan is still a deposit although it is no longer to the borrower's credit. The deposit is transferred to the credit of the person receiving the check. If that person keeps his account in the same bank the transfer consists merely of charging the borrower's account and crediting the new owners and giving credit in the new owner's pass book. But if the new owner of the credit keeps his account in another bank he deposits the check there and receives credit for a deposit. The credit is then transferred from the lending bank to the second bank.

The transfers between banks made necessary by such operations are made by what is called a clearing. That is, the orders or checks against bank No. 1 presented by bank No. 2 are cancelled against the orders or the checks on bank No. 2 in favor of bank No. 1 and only the balance left after the cancellation is complete is paid in money. For instance if the checks on bank No. 1 presented by bank No. 2 amount to, we will say, $916.50 and the checks on bank No. 2 presented by bank No. 1 amount to $1,075.50 then the clearing or cancellation would show a balance of $1,075.50 minus $916.50 or

$159.00 due from bank No. 2 to bank No. 1 which is payable in money.

The more nearly all the business of the community is carried on by checks and drafts the less money is required to pay balances. If all the business were carried on by checks all transactions would cancel and there would be no balances, just as a set of double entry books must balance when they are correct. It would be simply a transfer of credits from one account to another and all the banks would constitute just one big bank.

The point to be particularly noted is that while the loan we are examining is stated in terms of money no money is used in the transaction. It is credit and while it may sometimes be turned into money, or what we call money, at least 95% of it never is, but is transferred from one to another by means of checks and always remains a bank credit or deposit. This fact is shown by the statement already given from the Comptroller's report.

The popular idea that the bank lends the depositors' money is in fact a delusion. What really happens is that the bank lends its credit to whomsoever it will, taking in exchange for it the borrower's less known credit plus his security. The bank turns out its credit in two general forms — bank notes and bank deposits.

The fiction by which the banker gives the borrower credit for a deposit is convenient, and, in itself, harmless. But like any other fallacy, when the fact that it is a fiction is lost sight of, and this transaction is mistaken for a money transaction, then it becomes danger-

ous. We will return subsequently to a discussion of the effects of this fiction, continuing for the present with the analysis of this bank's operations.

The bank, up to this stage, has coined but $1,000 of our medium of exchange, of which $15 is profit. Now it goes on making loans in the same way up to say two hundred thousand dollars. It does not seem possible for a bank with but ten thousand dollars capital and fifty thousand dollars cash deposits to lend two hundred thousand dollars. However, this is not only possible, but, what is still more remarkable, the bank will still have left the sixty thousand dollars in cash and probably more. Our bank's statement would then be:

RESOURCES		LIABILITIES	
Cash	$ 60,000	Capital	$ 10,000
Loans and Discounts ..	200,000	Deposits	247,000
		Profit	3,000
	$260,000		$260,000

Like any other sleight of hand this magic is very simple when explained. The banker is not lending the depositors' money, as is commonly supposed, nor any other money. He is lending the bank's credit.

The amount of credit which our little ten thousand dollar bank with its fifty thousand dollars of real money in deposits can lend, depends upon whether it is a state or a national bank, and upon the nature of its deposits. Most state laws, like the national bank law, require each bank to carry a certain cash reserve, the amount of which depends upon the law governing the bank, the kind of accounts the bank carries, and whether it is a

country or a city bank. This money is called the legal reserve, and represents a certain percentage of the deposits which must be held either in the bank's own vaults in the form of cash or approved securities, or to its credit by a reserve agent. This cash reserve is necessary as a bulkhead against the loss of public confidence. It is ready money with which payment can be made in case of a sudden demand from frightened depositors. For this reason, bank laws require a larger reserve against demand deposits than against savings deposits, because the latter are protected by the requirement of notice before withdrawal. The time given by this notice gives the bank an opportunity to realize upon its assets, should such need arise. The legal reserve ranges from nothing in some states to twenty per cent in others.

Let us assume that our little bank is required to keep a 10% reserve. Then for every dollar it has in cash or on deposit with a reserve agent it can carry $10 in deposits. We have assumed that the bank has $60,000 so with this amount as reserve it can run its deposits up to ten times that amount or $600,000. Of this amount fifty thousand dollars are deposits of cash, which, deducted from the $600,000 fixed by the legal reserve law as the limit of deposits, leaves a balance of five hundred and fifty thousand dollars of deposits which the bank can create by making loans. The deposits—bank credit—created by these loans passes for money in the shape of checks and drafts and are in no way distinguishable from the dpeosits—bank credit—created by deposits of cash. If the legal reserve requirement then is ten per

cent, for every dollar of real money deposited or paid in for stock and held, the bank can issue or lend nine dollars of its credit for use as money.

And even bank reserves, it may be said, are not always money. Some states permit banks to count as reserves the bonds of that particular state and the notes of national banks. Neither of these are money, but only promises to pay money.

In the first chapter we saw that the causes for the social unrest of today and its attendant evils arise out of that defect in our monetary system which is responsible for the varying price of the dollar — or, in other words, for varying prices. The phenomena known as the High Cost of Living and the Low Cost of Living, and the distressful conditions that are the result of these phenomena are due in their entirety to the unstable value of the dollar.

In this chapter we have seen that the greater part of our money is bank credit. We have seen that at least ninety-five per cent of our circulating medium — of our money—exists in the form of bank deposits. And we have furthermore investigated the way in which this bank credit is created, and have seen that bankers are alone responsible for its issuance, that they can increase it by granting loans or curtail it by refusing them as they see fit. They can also grant a loan to one and refuse it to another at will.

Putting the conclusions of these two chapters together, it at once follows that the industrial evils described are due to some defect in our banking system,

since it is this system which controls our circulating medium.

Furthermore, we saw that under the present system the banker is acting as a brake on the wheels of prosperity; we noted, however, that this was not necessarily the banker's fault, but may be due to a defect in the system which does not permit him to extend credit wherever credit should be extended in the furtherance of the best interests of society.

We have now shown what we started out to show. It is now clear that both series of problems and defects referred to in the first chapter have a common origin. They are both due to a defective system of issuing bank credit. The problem, then, which at first seemed a twofold one, is now seen to be one — the problem of correcting the defect in our banking system. It is the problem of devising a remedy that can be applied to existing institutions without disturbing business or upsetting commercial relations.

But before doing this, it is necessary to see clearly what the defect is. This is our next step.

CHAPTER III

THE MEDIUM OF EXCHANGE A PUBLIC UTILITY

IN the preceding chapter it was seen that all but a relatively insignificant percentage of our commerce today is carried on by means of bank credit — in other words, that bank credit is our present medium of exchange.

And it was shown that in the development of commerce, one means of changing ownership after another came to be used. As commerce outgrew the means in use another had to be supplied.

It was noted that primitive barter, because it was too cumbersome and unsatisfactory, gave way to the practice of using one or two commodities as a medium of exchange. Gradually the commodities that were best adapted to this use — gold and silver — came to replace other commodities, shells, tobacco, iron, copper, and so forth. Subsequently gold largely took the place of silver on account of its higher value and consequent greater efficiency. We saw finally how bank credit, based on gold, arose and that on account of its greater convenience and adaptability to the needs of modern industry and commerce, it has reached the position that it now occupies, practically all of our exchange transaction being carried on through the use of this medium.

And we have also looked into a few of the most

obvious of our industrial ills today, and have seen that they are connected with, or rather that they spring from, some defect in our monetary and banking system.

The most natural conclusion to be drawn from these premises is, that, just as commerce outgrew each former medium used for exchange, so it has now outgrown the present one.

Commerce stands in need of a medium that will give it freer scope for its possibilities. It must be enlarged so that industry will no longer be hampered by a medium of exchange that restricts and represses business, that turns it inward like an ingrowing nail, there to rankle and fester and breed all the economic trouble and industrial turmoil that afflict us today.

Because our present system has been outgrown does not prove that there is anything inherently bad in the development of bank credit. Its use was a natural step, a step in advance, and by no means a step in the wrong direction. Its use gave industry wider scope, and so contributed to the advancement of civilization.

And if now it has been outstripped by industry, this does not necessarily imply that it must be cast aside, or that a search for a new and entirely different exchange medium is necessary to be instituted.

The case is really quite the contrary. No radical change is necessary. All that is required will be to modify the method of issuing our present medium in order to put it on a firmer, more logical basis, and by removing the fault that hampers it adapt it to present conditions.

It is only necessary to modernize bank credit, and set

it upon a more scientific footing. When this has been done, it will be fully adequate to all our needs. Industry will no longer be "limited, cribbed, confined," but will be free to develop the immense possibilities that are latent within it.

It is a most natural result that enlarged business requires enlarged facilities for doing business. All our efforts in achieving this improvement, by reorganizing our methods, will be repaid a thousand-fold.

But before attempting such a task, we must see more clearly just where our present system is at fault; we must look more closely into bank credit, as it exists today, and determine precisely where it is inadequate. Then, and only then, can we seek to apply a practical remedy. With this purpose in mind, let us look once more into the way in which bank credit is created.

Bank credit may be created in either of the following two ways:

When a customer deposits money, the banker gives him credit in like amount on the books, and makes a memorandum to that effect in the customer's pass-book. The money deposited becomes the property of the bank, in exchange for which the customer receives the bank's promise to repay the amount on demand. In other words, credit on the bank's books is bank credit, and is created first by *bank deposits.*

When a customer goes to a bank and "borrows money," he puts up his note with his securities, if the note be secured, and the banker gives him credit for the amount he has borrowed in the same way as he gives the cash depositor credit for his deposit. The banker makes the

same memorandum in a Borrower's pass book that he does in a depositor's. Bank credit, then, is also created by *bank loans.*

The point in both these cases is not that bank credit is created by two entirely different methods, but that in each method the question as to whether the bank credit shall or shall not be created is left entirely to the banker. He may make the loan, or he may refuse to make it. If he refuses no one can compel him to alter his decision, regardless of what may be the borrower's just deserts.

In the other method too, he may refuse the deposit if he so desires. It is not often that a banker refuses to let a customer make a deposit, but it is quite possible that he may regard some particular person's account as undesirable, and in that case there is no means of compelling him to accept the deposit.

The credit thus created on the bank's books is transferred from one to the other by checks and trade is carried on almost exclusively by its use, it is our money, so the bank has virtually become our mint and its operation is a matter of vital interest to all of us. A full analysis of the effect of this usurpation of a great government function by the bank will reveal the cause of our financial ills.

We have seen that THE POWER TO GRANT OR DENY A LOAN, AND SO THE POWER TO CONTROL THE MEDIUM OF EXCHANGE, RESTS WITH THE FINANCE COMMITTEE OF THE BOARD OF DIRECTORS OF THE BANK. This simple act of routine business is performed every day

by hundreds of good citizens, who would indignantly resent any suggestion that by this act they are usurping one of the most vital functions of our government—that of issuing our money by minting private credit into the medium of exchange.

But because the bank's credit, which this committee controls, is our medium of exchange, and because the use of the medium is necessary in every walk of life, it is clear that on the decision of this committee depends individual liberty, success, and happiness, as well as national efficiency and progress.

The great importance of its decisions make this little assemblage of business men a powerful group of autocrats. Their power is the more dangerous because of the fact that their acts are protected from even the slightest public protest or criticism. Both the committee and its victims fail to realize the power that it wields.

Right here, in these committees, lies concealed the "Money Trust" of which we hear so much. The control of the greatest public utility is in their hands.

This is the clue to our entire problem. The PRIVATE CONTROL OF THE MEDIUM OF EXCHANGE SUBJECTS THE WHOLE COMMUNITY TO THE WILL OF THE FEW.

Many will note a resemblance here to another great problem—the railroad problem. As many will remember, the private, irresponsible control of the medium of transportation by a small group placed the entire community within their power.

Since a similar trouble was overcome in that public utility, a review of the problem presented there, and of

the means by which it was solved should prove of considerable help in the present problem.

In the days when railroads were entirely in private hands, and subject to no public control and regulation, the principle which governed all rates was to charge that rate, both for passenger and freight service, which would yield to the railroad lines the largest net returns, regardless of the community's interests in the matter.

For those who remember this period in our history, no explanation is necessary. Our sad experience with complicated and unjust railroad tariffs, unpublished and secretly administered, and with rebates, drawbacks, terminal rates, quantity classifications, and an untold number of similar abuses, will not easily be forgotten. But for the benefit of the younger generation, let us take an example.

When railroads were privately controlled, California's supply of kerosene came from the East. Let us say it cost fifteen cents per gallon to produce kerosene in, we will say, Ohio, and that it sold regularly in California at forty cents. Then the railroad would figure perhaps a profit of five cents for the producer in Ohio, and perhaps another ten cents profit for the seller in California. It would then fix its rate at the difference between the cost plus the two profits allowed, and the selling price of forty cents, that is, ten cents.

The only principle governing this rate was, "at what rate can that particular business be made to pay the railroad the most money?"

Different rates were quoted to different shippers. Business success depended more on "pull" than on

"push." A little pull with the railroad was worth any amount of energy and business ability.

To demonstrate this last statement, let us continue our illustration a little further.

Suppose the railroad raised the rate on kerosene from Ohio to California by ten cents, making it twenty cents. It is not likely that this increased rate would be absorbed by either producer or retailer. It would be shifted to the consumer, who would have to pay fifty instead of forty cents per gallon. This would result in decreased consumption, and consequently decreased business both for producer and railroad.

But now suppose that certain of the interests producing kerosene in Ohio also possessed a sufficient control over the railroad to cause the latter to rebate eight cents per gallon of the freight rate on kerosene to them. In other words, these producers would pay the railroad the full twenty cents per gallon rate, and later the railroad would pay back to them eight cents per gallon. Then instead of only five cents per gallon these interests would make thirteen—a good compensation for the diminished sales. The extra two cents per gallon from these producers, coupled with the extra ten cents per gallon from other producers, who did not enjoy the rebate, would amply repay the railroad for the shrinkage in traffic due to shrinkage in consumption.

The favored kerosene producers and the railroads would both be pleased with the arrangement, even though the demand for kerosene had diminished.

But how about the producer in Ohio who was not favored, and had no compensation for the decreased

business due to the increased price? And how about the consumer, who now had to pay fifty instead of forty cents per gallon, and consequently had to content himself with a smaller quantity of kerosene than before?

Since that time railroad service has come under public control. No longer are railroads permitted to increase rates arbitrarily, nor to favor some shippers in preference to others. All shippers are entitled to the same services, and prices no longer fluctuate at the will of the railroad interests. And right here let us point out that neither in the case of the railroads, nor in the case of the banks, are we interested in the operation of either of these public utilities, except in so far as their operation affects the quality of the services they render.

It is in the services that we are interested, and so long as all customers may know at all times what service they may expect, and may be sure of receiving the same treatment as any other customer, it is of little importance to us, the public, as to how that service is produced.

Banks as well as railroads should be privately owned and operated, but their SERVICES should be under public control and regulation so that everyone may be certain of obtaining the most efficient service at the fairest cost and a service equal to that of any other user.

Because the banks issue our medium of exchange the banking and railroad businesses are both public utilities.

The only essential difference between the services rendered by these two utilities is that the *cars* of the railroad are employed to change the location of goods while the *credit* of the bank is used to change their ownership.

In abstract principle both are the same, and the effect of private or public control of either has the same result.

It is evident that as long as a privately controlled railroad could charge "all the traffic would bear," and could then rebate a portion to favored shippers, or could favor them in other ways, that it was practically denying to those shippers not favored the right to use the railroads.

Precisely the same thing happens when a bank denies a customer a loan for which the customer can offer security. It is denying to that customer the right to use a medium which is much more important to him than the railroad.

It is in the fact that the bank can deny anyone the use of this great public utility that the greatest fault of our present financial, industrial and social system lies.

In order to make the analogy still clearer, we may compare the security offered and the rate of interest paid by the customer of the bank to the freight-rate paid by the customer of the railroad—the shipper.

Under public control every railroad is now required to give every shipper, who can pay its rate, the same treatment as every other shipper receives. It cannot deny its service to any particular shipper on account of the prejudice or the personal interests of any person or group of persons who may happen to be in control of the railroad.

And the medium of exchange, the service offered by the bank, should be under similar public control, so that every bank will be required to give identical treatment to every customer who can comply with require-

ments—who is able, in other words, to offer good security and pay the rate of interest. The decision, whether to make the loan or not, should not be permitted to lie in the hands of private persons, who may decide according to their own personal prejudices or private interests.

It may perhaps occur to some here that the force of competition will overcome the effect of personal prejudices and private interests of the bankers. In answer to such an argument it is merely necessary to say that the force of competition does not operate, and to prove this statement we will again call upon our analogy to the railroad.

It was thought that the free play of competition untouched by public regulation, would be sufficient to insure fair play to all shippers. The countless instances of rebates, secret tariffs, and similar abuses that characterized the day of unregulated railroad competition, proved beyond all doubt the necessity for public regulation.

If we desire to benefit by past experience—and who does not?—we must apply the same rule to our other great public utility.

Just as the argument that since it was the railroad's business to secure the transportation of goods, the railroad would afford the best possible treatment to all customers, was found to be invalid, so the argument that, since it is the banker's business to extend loans wherever possible, he will extend equal services to all customers, will also be found fallacious.

There is one more point of striking similarity between the two public utilities, the railroad business and

the banking business, that should be referred to before our analogy between the services of these two utilities is completed. This point is the similarity in effect upon the community of a denial of, or break down in, the services of either.

The effect of a breakdown in railroad service was illustrated with gripping force in Mexico during the Carranza regime, when thousands of Mexicans died from actual starvation. Beset by bandits and lacking credit, the government was unable to obtain adequate rolling stock for its railways, which were, with minor exceptions, federally owned. Owing to this lack of rolling stock, the crops could not be moved. In the agricultural districts corn was cheap, for it could not be sent to other markets, and so glutted the local markets. Business stopped from lack of transportation. On the other hand, in the mining districts, many people died from sheer starvation, for owing to the lack of adequate means of transportation, corn could not be brought in from agricultural districts. What corn there was consequently rose to so high a price, and was so scarce that many could not get it at all, and died from famine.

Just as "contraction" of the medium of transportation caused hard times, so "contraction" in the medium of exchange causes hard times, as will be shown in the following illustration.

A man, let us say, owns an unimproved farm worth $10,000, and is desirous of improving it. He needs, say, $2,500 for barns and sheds, and $3,500 for implements, seed and running expenses until he can harvest his crop. He has no other means of raising the money

except on the land. He is willing to give a mortgage for the $6,000 needed, agreeing to spend the money on improvements as stated, which will make the security offered, the farm, worth from twelve to fifteen thousand dollars. A good security for the loan of $6,000.

The lumber agent will not let him have the lumber, the carpenters will not put in their work, the tractor men will not furnish the tractor, and the implement and seed dealers will not furnish his other necessities unless he is able to pay them. He will not be able to pay them until he gets his crops, perhaps not until he has sold the crops of a number of years. But if he succeeds in raising the loan from his bank, he will be able to raise the crops and pay it back.

If he is granted the loan, then he will be able to carry out his proposed improvements. The result will be in the immediate future, a demand for lumber, farm implements, and labor to the extent of $6,000, and prices and wages will rise or be maintained as a result. In the slightly more distant future, the result will be larger and better crops, and so society will twice be benefited, once in increased business and again in a better supply.

But if the loan is refused, the result will be the opposite. The demand for the commodities and for labor will be lessened to the extent of $6,000, thus depressing prices and wages. And the farmer, finding no other outlet for his energies, and no other means of getting a living, will have to go to work for somebody who can get the use of the medium of exchange. Not only will the goods which he would have bought and the labor which he would have employed remain on the market to

depress prices but also his labor will be thrown on the market, thus further depressing the wages of all labor. In general, then, if the loan is for any reason refused it is not a personal matter between the would be farmer and the banker for the result will be a tendency toward hard times and loss for the whole community.

This denial of the use of the medium of exchange, then, produces "contraction," which unfailingly results in falling prices, lower wages, lessened production, fewer comforts, and a decrease in happiness just as inadequate railroad service does.

Financial writers formerly blamed such evil conditions upon "over production."

They calmly told us that the reason prices fell and business slumped was because the market was over supplied.

But now, with want and starvation crying for our surplus, with our ships tied to the dock and the railroads suffering for lack of freight the term, "over production," would sound ridiculous so the same condition is described as, "lack of demand."

The latest term is, "a buyers' strike." This term aptly describes the condition for of course all buyers strike, that is they do not buy, when they have nothing to buy with, and we have just described how the farmer, unable to get his loan, "struck" and went to work.

The term "Buyers' Strike," however, is not well chosen, for it puts the blame in the wrong place. As we have seen in the farmer's case, the failure to buy was no fault of the buyer but was due to the banker's refusal to make the loan, so this failure to buy and our present

bad condition would be much more accurately described if termed a "bankers' strike."

All such terms as, "Over Production," "Lack of Demand" and "Buyers' Strike" are misleading for there can be no over production and buyers will not strike so long as desire remains unsatisfied. The fact that present unsatisfactory business conditions are caused entirely by bankers and not by buyers will soon be clearly established.

This condition will be explained more fully in the next chapter, in which we will examine closely the reasons for, and the results of, a denial of the use of the medium of exchange to whoever deserves to have its use extended to him. And it will be shown that the denial is due entirely to the private control of our greatest public utility.

The farmer should have the same right to the use of the medium of exchange that a shipper has to the use of the medium of transportation.

In the case of the shipper, the value of his shipment is a guarantee that he will pay for the use of the railroad. With the farmer, land and crop insure payment for the use of the bank. And any abridgment of this natural right not only denies him freedom of action, but results in loss to the entire community.

Due to this denial the lumber, implements, seed and labor the farmer would have bought remain on the market to depress the prices of those commodities because he could not buy what he wanted to buy and the crops which he would have raised are not raised for the same reason. Society, therefore, instead of enjoying a double

gain, suffers a double loss on account of the denial.

This is just a statement, in particular form, of what we have demonstrated in this chapter, namely, that the fault of our present financial system lies in the fact that the banks control the greatest public utility; a utility which all must use is held in private hands, and from this source springs practically all of our present financial, industrial and social troubles.

Let us now proceed to examine in greater detail the effects of this private control so as to see how it produces the hardships from which the country suffers.

If it is proved that our present business depression is due to this cause our problem is then fast approaching solution. This fact will be clinched in the next two chapters.

CHAPTER IV

THE INDUSTRIAL STRAIT-JACKET

IN the last chapter it was shown, by analogy with a similar problem in the case of the railroads, that the private control of bank credit lies at the root of our present industrial troubles.

In this chapter it is proposed to further investigate this proposition in order to show conclusively, the evils of private control of the medium of exchange, and secondly, in order to gain a more definite and a clearer conception of the fault so that we may be aided in our search for a remedy and may better appreciate the remedy when it is found.

In the early part of this book we saw how a great part, if not all, of the evils which afflict industry, and, in fact, society as a whole, at the present time, are evils connected with the changing cost of living. In other words, they are due to the fluctuating general level of prices, or differently expressed, to the variation in the purchasing power or price of the dollar.

This variation in the value of the dollar is due to the phenomena called expansion and contraction or inflation and deflation, which condition arises from the fact that the volume of the medium of exchange does not vary in accordance with the needs of business.

It is clear that if the volume of business remains constant and the medium of exchange is doubled, prices

will in the long run be doubled—that is, they will tend to be doubled. For now there will be two dollars to do the work that formerly one dollar did.

On the other hand, if the volume of the medium of exchange remains the same, and the amount of business done, the total amount of goods produced and handled is doubled, then prices will tend to be cut in half. For now there will only be one dollar to do what two dollars did before; each dollar will have to be twice as effective as before.

But if the medium of exchange varies hand in hand with the volume of business, then there will be no fluctuation in prices as a whole.

That is to say, if the volume of business is doubled, and the medium of exchange is doubled at the same time, each dollar will have to do just the same amount as before, and prices in that case will remain constant. The same condition will result if the medium of exchange and the volume of business are both halved.

This is the object of practically every monetary reform. It is the object, for instance, of the Federal Reserve System. But it is an object that has not been accomplished, for we still have our varying general price levels. The cost of living has not ceased to rise and fall since the introduction of the Federal Reserve System, as has been clearly demonstrated in the past few years.

It should be held in mind during this discussion that we are speaking, not of the variations in price of particular commodities, but of variations in the general level of prices as a whole. Variations in the price of

particular commodities are due to variations in the demand for, and the supply of these commodities.

But variation in the general price level, the price of all the commodities consumed by a community taken as a whole, are due to variations in the price of the dollar, that is in the purchasing power of the dollar. The dollar value varies with the ratio between the volume of the medium of exchange—the number of dollars in circulation, and the volume of business transacted.

Variations in the purchasing power of the dollar are the cause of industrial and social unrest and of the hardships connected with the fluctuating cost of living. These variations in living cost result in the adjustments of the mode of living to income, made necessary when changing from one price level to another.

It is, as stated, the object of almost all banking and monetary reforms to do away with these fluctuations in the general level of prices. It is evident that the only way to accomplish this object is by an arrangement so that the purchasing power of the dollar shall remain uniform. But this end will never be accomplished until control of the volume of the medium of exchange is taken out of the private hands of the banker, for it is owing to his control that the volume of the medium of exchange does not vary in accordance with the volume of business. One reason for this lack of elasticity in our medium is because the private control of the banker always results in a tendency toward contraction.

In order to demonstrate this fact it will be necessary first of all to show clearly what we mean by the terms contraction and expansion. This can be most easily

done by having recourse once more to our analogy to the railroad.

Contraction of the medium of transportation means that there are not enough railroad facilities to carry on the business of transportation. This situation occurred in Mexico during the Carranza regime as related in the last chapter. The result of this contraction in railroad facilities was a stagnation of business in all regions affected. In agricultural districts there were low prices for food and high prices for everything else. In the mining districts the mine products, if they had been in demand at all in those districts, would have been very low, but the prices of all other commodities which had to be brought into the district by railroads were very high. As these other commodities included food, many people starved owing to an insufficient supply of food.

Contraction of the medium of exchange has the same result. It implies an insufficiency of the medium to properly carry on the volume of business offered. A very serious result of such a condition will be described in the chapter on "National Efficiency" where the case of China will be discussed.

Referring again to an illustration in the last chapter we saw that if the farmer could not get a loan, his projected improvement could not be carried out. The refusal of the loan was an act contracting the medium of exchange. Such acts tend towards business stagnation, for if many are placed in the same position as the farmer, so that they are prevented from carrying out the business ventures they have contemplated, business will stagnate.

Just such a condition happened in Mexico owing to lack of transportation facilities—stagnation of business. And it is found to happen always as a result of contraction of the medium of exchange.

The only way industry can be carried on is by means of the medium of exchange, so with every expansion of industry the demand for credit becomes greater and unless its volume increases in the same proportion, business lags, industry hesitates and hard times and want follow as a result.

An increase in the demand for credit raises its price, or in other words, the discount or interest rates go up, and they continue to go up until they get so high credit cannot be used profitably. Contraction then results, which, of course, stops business expansion. This condition always means curtailment of production, resulting in curtailed employment and reduced wages. In this way any movement toward increased production results finally in the contraction of the medium by means of which business is carried on.

Several reasons will be noted why, under private control, the medium cannot expand to keep pace with the productive energy of all the people, so the final result of private control is that prosperity must invariably be followed by what we call "hard times."

Expansion, or inflation, of the medium of transportation and of the medium of exchange are the opposites of contraction, and the results of expansion in both cases are similarly analogous.

If more transportation facilities are supplied to a community than required, they will not all be used until the

community has had a chance to grow up to them. Meanwhile, however, such a condition would have the effect of lowering transportation rates, which would be a bid for greater production and greater consumption—that is —a better standard of living.

The same is true of the medium of exchange.

The community can use just so much credit, and if more is offered it will drive down interest rates; which in turn will invite increased business activity.

Inflation, then, is in itself simply a bid for increased energy of production and increased comforts and happiness for the members of the community.

These results are certainly not evil. But with our present system the indirect results of inflation are bad, for due to private control of bank credit, inflation is invariably followed by a period of deflation, or contraction.

The sequence of the phenomena of inflation and deflation can easily be seen.

Industry expands only by means of an expansion in the medium of exchange. When the medium expands, that is to say, is inflated, industry expands the more easily. But production soon outstrips the expansion of the medium and demands further expansion in proportion to the increased production. If this fails we have once more the sequence of increased demand for credit increasing the interest or discount rates until they are so high that credit cannot be profitably used, and so we come down again to a period of lowering prices and hard times.

Under private control of the railroads we had the same result.

Great demand for transportation service would raise the rates until the high rates would curtail shipment.

The reason just referred to is a very potent one why, under the present system of private control of bank credit, there is always a tendency towards contraction—that is, there is always a tendency toward deflation or restriction of credit and hence against the expansion of industry.

We saw the result of this in the very beginning of this book, in the case of the automobile dealers, who are now unable to obtain the credit necessary to carry on their business.

The private control of the medium of exchange is a constant bid for credit restrictions which invariably brings on recurring periods of hard times, and until the medium of exchange is freed from private control, the dominating private interests will continue periodically to disrupt and oppress business through the curtailment of bank loans.

It may seem to be a matter of no particular interest that a business man a thousand miles away cannot get a loan from the bank, or that the bank will no longer discount the automobile dealers' paper. However, when a large number of such loans are refused, the effect on the private business man whose loan is refused is not the only effect.

A merchant for instance fails to order goods because the banker will not grant him proper credit facilities for handling them; the manufacturer then curtails production because of the lack of orders; in consequence of which working-men are thrown out of employment. Hard

times for industry and business as a whole are the result.

It is now quite clear that the grant or denial of a bank loan is not a private affair between the banker and the borrower, since the result directly affects all business activity and the prosperity of the whole community. For just so long as we allow the volume of the medium of exchange to be controlled by a few men we are not only permitting those men to dictate our individual success but to control all the wheels of industry.

One reason, then, for the bad effect of private control over the medium of exchange is due to the fact that the banker invariably tends to cause contraction in the volume of bank credit. This tendency springs from three separate causes.

The first reason is that it is to the interest of those in control of the banks to contract the medium of exchange for, as we have seen, a contraction in the exchange medium relative to the volume of business results in a lowering of prices: for one dollar must now do more work than it did before.

The creditor interests are the ones in control of the banks, and since their loans are expressed in terms of dollars, it is to their interest to make those dollars worth as much as possible to them. That is, they want the dollar to buy as much as possible—in other words, they desire low prices.

If the price of wheat is one dollar a bushel, the creditor, who is in control of the bank, will get twice as much wheat for his money as he would if the price of wheat were two dollars a bushel. Therefore, it is to the banker's interest to curtail the medium of exchange, since such

curtailment lowers prices of commodities and thereby increases the purchasing power of his dollars.

Not alone does it accomplish that purpose but it increases the interest or discount rate he charges for their use, so those who control the banks not only increase their fortunes but their incomes at even a greater rate by a process which decreases business and increases debt.

The present system causes producers and debtors to suffer while the non-producing creditors may fatten.

The second reason for contraction is due to the banker's timidity, and his timidity is largely due to the fact that gold is at present the only commodity which is supposed to form a basis for the credit which is our medium of exchange.

The banker, as we have seen, has to keep a reserve behind his deposits, and this reserve must either be in the form of gold or other money supposed to be redeemable in gold. On this account the banker is interested in the country's gold supply, and consequently whenever gold is shipped out of the country in any considerable amount or prosperity makes a demand for the expansion of credit the banker gets into a state of panic and begins to refuse and to call loans.

The irony of the situation is that every move he makes to escape an approaching imaginary financial storm hastens the approach of a real one and adds to its fury when it breaks. His fear of a possible panic produces genuine panic.

Such panics occurred on an average of once every ten years during the eighty years preceding 1907, but in spite of their frequency they were not understood.

The banker, as we have seen, began to refuse and to call loans, fearing an impending calamity. This reduction of loans meant a shrinking in the volume of the medium of exchange. As a result money became tight, trade decreased, prices fell, production diminished and the value of the security behind the still outstanding loans shrunk. In consequence of this condition the banker became still more afraid.

He refused loans in the first place because of a belief that some change was going to take place in the financial world that would make it unwise for him to extend credit. He became still more afraid when he saw the result of his action and then he began to call more loans. This action caused still tighter money, greater stringency, and a further decline in prices, securities, and wages.

Then there followed business failures, caused by the restriction of credit. Bank runs resulted, bringing in their train bank failures, and the commercial world was prostrated in a delirium of fear. All of which resulted from the banker being afraid of his own shadow.

The Federal Reserve System now tends to protect the banks so that the financial panics that occurred every ten years up to 1907 seem to be overcome, but it does not protect the rest of the community from loss because of falling prices due to deflation nor does it remove the inevitability of periods of contraction, business stagnation, and industrial turmoil following prosperity.

In the chapter devoted to the "Federal Reserve System" an entirely new light will be thrown on that much misunderstood institution. Periods of depression will

continue to follow periods of prosperity until their cause, the private control of bank credit, is removed.

In former years after the decennial panic just described had finally exhausted itself, confidence would begin to return, and credit would slowly become readjusted. Soup kitchens would close, and those who had the courage and health to start life anew would get to work, and again deposit their savings with the banks.

And then the banker, ignorant of the fact that he was the cause of the panic, would assert that it was the effect of tariff tinkering, politics interfering with big business, over production, overspeculation, or anything else he had a particular aversion for. And the public thought "Yes, I guess that was it," for the banker ought to know. While the fact was, as we have seen, that the banker was the unconscious cause of the whole trouble.

A closer examination of the situation will disclose yet another fact, namely, that he just as unconsciously overruled the will of the people.

For the purpose of analysis, we will take a cause which was formerly used as a scapegoat more often, perhaps, than any other—tariff changes due to change in national administration.

This change in administration, could come about only by means of more votes being cast for low tariff principles than for high tariff; that is, more than fifty per cent of the voters of the country must have expressed a desire for such a change in the government policy. But when the change in tariff was made or threatened, the banker began to get pessimistic as to its effect on business.

He told his fears to customers applying for loans and advised them to wait a little to see how the change was going to affect them before they bought more goods or enlarged their business.

Although a customer might disagree entirely with the banker as to the effect of the legislation, the important fact remained that the customer did not get his loan, because loans were, and still are, issued solely on the banker's judgment.

A difference in opinion between the banker and more than fifty per cent of the voters of the country had thus denied to a responsible business man the right to use a needed amount of medium of exchange. He could not obtain the goods he intended to buy or increase his business.

The wheels of commerce were stopped to such an extent that this stoppage was reflected back through the whole complicated fabric of business. This condition forced other business men to curtail business and cancel orders, creating what economists now describe as a "Buyers' Strike." It required comparatively few setbacks like this to shock the commercial structure to its foundation.

It should be carefully noted that his refusal of the use of the exchange medium was not the effect of the judgment of the banker, but the effect of his timidity. Thus it is seen that the banker's fear of impending disaster following a political change not only prevented the proposed or enacted tariff change from having a fair trial, but it falsely charged politics with causing panic or hard times.

It could hardly be more certain that through control of the medium of exchange, the banker thus nulified the will of the people and refuted the claim that our government is one of the people by the people and for the people.

Now we have seen two reasons why private control of bank credit will always tend toward contraction of the medium of exchange with its bad results.

These reasons are, in the first place, the fact that it is to the banker's interest to curtail the medium of exchange, thereby lowering prices and making the debts owing him the more valuable, as well as increasing his income by raising the interest rate.

In the second place, on account of the banker's timidity, causing curtailment of loans as we have seen which caused business depression, and before the passing of the Federal Reserve Act, also caused periodically recurring financial panics.

But there is still a third reason why our medium of exchange, as it is constituted today, will invariably tend to contract when prosperity increases the demand for it and this reason hinges upon two circumstances.

The one is the gold standard, by which gold forms the basis of our medium of exchange, coupled with the fact that the price of gold is fixed at $20.67 per fine ounce. That is, the amount of gold worth one dollar is fixed by law at 23.22 grains which amounts to the same thing. The second circumstance is the increasing difficulty in the production of gold.

Gold is a commodity in all respects similar to any other commodity, with the exception that its price is fixed by

law. It has to be produced, by the process of mining, and it has a varying cost of production.

As with every other commodity, when the cost of production increases, the price should also increase. Take coal, for instance. As mines become gradually exhausted, and the producers have to dig deeper and deeper, the cost of producing coal increases. Then, unless other sources of coal are found, where the coal is more easily and more cheaply obtainable, the price will increase.

When the cost of producing gold increases, the same thing should happen—the price of gold should increase. But we see that the price of gold is set by law, which says that 23.22 grains shall be worth one dollar by saying that the dollar shall consist of that amount of pure gold. The law does not set the price of any other commodity, it does not say, for instance, how many dollars a pair of shoes are worth. But it does fix the price of gold.

Now bank reserve requirements make a reserve of gold behind paper money and, therefore, of deposits necessary. The banker must keep his reserve either in money, or in credit supposed to be redeemable in gold. Consequently, the amount of gold held restricts the amount of the medium of exchange that can be issued.

As industry expands, the medium of exchange should expand, or we will have contraction, with its evil consequences. But the expansion of the medium of exchange is limited by the amount of gold and gold is limited by production.

The cost of gold increases with the cost of mining and milling.

Consequently if prosperity raises the price of labor and the commodities entering into gold production then production will decrease because the price of gold is fixed by law and cannot increase with the cost of production.

Here once more we see an inevitable tendency towards contraction.

But there is a paradox here, too, which shows that not only because the price of gold is fixed, but also because gold alone is used as the basis for our medium of exchange, we have this tendency toward contraction.

Expansion of industry under our present financial system invariably means a period of rising prices. Expressed in gold, it means a fall in the price of gold. And we have seen that in order to increase the volume of the medium of exchange so as to keep pace with increased business it was necessary to increase the amount of gold produced.

As with other commodities, this can be done only by increasing the price of gold as its cost of production increases. Unless the price increase keeps pace with the cost increase gold production decreases and thus compells contraction which strangles business.

Could anything be more absurd than a system which causes prosperity to check prosperity?

Such a system is on a par with the building of an automobile and putting the reverse gear where the high speed should be. Every time the gears are thrown into high the machine backs up.

Even the slightest acquaintance with machinery must show that such an arrangement would throw a very

great strain on the whole mechanism and but little reflection is required to show that our financial system is so arranged that it is an automatic reverse on our industrial and business activities. Consequently the whole social system is shocked instead of benefited by a wave of prosperity. The bad effect which such an arrangement has on the system is shown in industrial turmoil and social unrest.

It begins to be clear that there is something radically wrong with the gold standard. Further consideration in the chapter on "The Gold Standard" will strengthen this conclusion.

We have seen that the control of the medium of exchange is in the hands of the banks and banks are largely controlled by the "vested interests," or non-producing creditors to whose advantage it is that prices shall fall. For this reason the result of private control is always a tendency toward contraction of the medium of exchange. And we have also seen that the gold standard aids in that tendency.

We must conclude then that the gold standard is the ally of the vested interests, since its tendency is in the direction most profitable to those interests.

The gold standard and the "vested interests" are but phases of the fault that is at the bottom of our trouble. Private control of the medium of exchange is the real fault. Basing our medium of exchange upon one commodity, gold, makes the private control of bank credit still more effective, in as much as the bankers are enabled to gain control also of the gold. And so long as our medium of exchange is controlled by a gold reserve

and is in the hands of private interests, prices and wages must come down and debts go up whenever the gold production falls off. It is an automatic break on national efficiency and personal prosperity.

Although this defect is but another phase of the general fault, and serves only to intensify the evil effects of private control, it is, nevertheless worthy of special study. The gold standard idea, through a fallacy, is deep rooted and while of no consequence in our remedy it should be understood just because it is fallacious.

The next step, therefore, will be to study the gold standard, not exhaustively, but only to see how it arose, and to note some of its present deficiencies, and also to understand how it adds to the evils of private control of our real medium of exchange—bank credit.

CHAPTER V

"FROZEN CREDITS"

IN TRACING the development of our present medium of exchange, we saw how, for purposes of greater convenience, one or two commodities came to be used almost exclusively. Gold and silver had the advantages of possessing great value in small bulk; they were, therefore, convenient to carry. Their scarcity also gave them a more or less steady value, and so they came to be selected instead of other commodities as the medium to be used in changing the ownership of goods.

Gold possesses, even to a greater extent than silver, the qualities enumerated above and so naturally became the more important medium, or money, while silver to a great extend lost this dignity.

Both of these steps were part of a natural development and each was an improvement over the former. By the use of something with a fairly definite value as a medium, a much greater amount of trading and commerce could be carried on than under the cumbrous form of direct barter, or by the use of a medium of uncertain value. But a time came when even this improved method of transacting business became inadequate for the needs of commerce.

The amount of the commodity was limited. Gold does not increase as population increases or as business activity increases, but only through the discovery of new sources or of better methods of production.

Consequently, since its use was necessary in order to effectuate the exchange of goods and services, just as rolling-stock is necessary for transportation, increased business called for more gold. This increased demand for gold as a medium for carrying on business resulted in the community bidding higher for its use.

Thus, a man who had one thousand bushels of wheat which he wanted to trade for improvements, clothing, etc., would offer more and more wheat for the use of the medium of exchange according to its scarcity and according to how pressing were his demands for the things he wanted or the debts he had to pay.

In other words, if the supply of gold were not increased to meet the needs of an increased volume of business, prices would keep going down until business stagnated and production fell off to such an extent that the community suffered.

As industry increased, then, a greater amount of the medium of exchange became necessary. The supply of gold did not increase with sufficient rapidity to supply this need, and so some other medium had to be used in addition to gold. Credit arose to meet this necessity, and credit has since then grown and expanded until today it forms almost the entire amount of our medium of exchange.

This use of credit was a natural development, and as in the case of those mediums that preceded it, one that was an improvement over former conditions. Perhaps for the reason that it was a natural step it did not take the form that would have been most suitable. At any rate from the defects already mentioned it would

seem that once more we have come to such a stage in industrial progress that a further improvement is necessary.

This does not mean that something other than credit is required to serve as a medium of exchange. Nor does it mean that we must discard gold. What is necessary is to put credit on a broader basis. Increase its carrying capacity just as we increased the carrying capacity of our railroads to keep pace with our idustrial development. Reorganize it, bringing out its immense possibilities. Once this has been done, it will become an adequate instrument of exchange. One so perfect, in fact, that it will satisfy all the demands of trade and industry.

In order to broaden the basis of our credit and accomplish the desired result, it will merely be necessary to put bank credit upon a basis of truth. Its evolution shows it developed upon a false basis and it still rests on a promise of gold redemption which we all know cannot be fulfilled. Let us see what this statement means.

We have seen that the earliest development of credit or rather bank credit, as we use it, was in the hands of the goldsmiths. It started when they made a practice of accepting deposits of gold and silver and giving receipts therefore. These receipts, on account of their ready convertibility into gold, became negotiable. In other words, these notes or receipts began to circulate as money, because of the goldsmith's reputation for reliability in paying gold on demand for his notes.

As a result of this reputation, the goldsmith found that the people, for reasons of convenience, would rather have his notes than metal money.

Soon he accumulated a great store of the precious metals that was seldom called for. The better his reputation for prompt payment, the less frequently he was asked to pay. So he began deliberately to trade on this public confidence, and sell his credit for use as money.

As long as he could retain the confidence of the people by always paying on demand, there was no limit to the receipts that he might issue.

Thus we see the development of a practice which continues today and which causes the basic defect in our present financial system. The goldsmith's deception is still continued by our banking system and it will soon be shown how it causes our trouble.

The goldsmith issued credit, pretending it was backed up by gold. He gave a receipt for gold which had not been deposited.

Although, on account of the necessity for some improvement, the growth of credit in this way did some good, nevertheless the fact that it is founded upon deception has hampered it and kept it from functioning as perfectly as it will when put upon a foundation of truth.

Banknotes and government paper money form one part of our credit today. They are promises to pay in gold. Yet, as will be shown subsequently, it would be physically impossible to fulfill this promise, for the simple reason that there is not enough gold obtainable to do so. This form of credit is, therefore, based upon a fallacy.

Similarly with bank credit. The fallacy in this case takes a somewhat different form, but in effect it is the same. The depositor thinks that he is handing money

to the banker which will be kept for him. The borrower thinks he is borrowing money from the bank. Both of these ideas are incorrect.

When a customer deposits money with a bank, the banker does not become a trustee for this money, promising to take care of it for the customer. The money deposited becomes the property of the bank, in exchange for which the bank gives its promise to pay back that amount on demand.

As we have seen in a previous chapter, the banker uses this money just as the goldsmith did. He holds it and uses it to pay whenever he is called upon to pay. As long as he can pay when demand is made his promise to pay is good so he trades his promise to pay to those who want to borrow in return for their promise to pay him.

It has been shown that these bank "loans" are made by giving the borrower credit for a "deposit." The borrower has made no deposit but has simply traded his promises to pay in the shape of a promissory note for the bankers promise to pay in the shape of a credit on the bank's books.

The very fact that when the banker makes a loan he gives the borrower credit for a deposit the same as he gives the depositor credit shows that the banker is not a trustee for money deposited but is a debtor of the depositor.

Like everyone else he will pay when he can and the system is framed for the purpose of making the customer think that he can always pay.

The object of the Federal Reserve System, explained

later, is to increase credit by increasing public confidence in the banks. Its purpose is to keep the customer believing the banker can pay. By so doing the system prevents too many customers from demanding payment at the same time and so prevents bank runs and panics.

Just as in former times people accepted the goldsmith's receipts as money because they thought that there was an equivalent amount of gold behind them, so today people accept banknotes and other bank credits because they think that they can get money or gold in exchange for them if they so desire.

Now it is true that during normal times, when there is little demand for gold, it is possible to get both bank credit and paper money redeemed in gold. But in abnormal times and whenever there has been really a demand for money, when people most urgently need gold, then they could not get it. And the reason why they were presented from having their notes and checks redeemed in gold was because there was not enough gold to supply the demand.

The promise to redeem in gold still continues while fulfillment of the promise has become more and more impossible until now it is little less than a joke. The extent to which this joke has been carried by a complicated reserve system will be pointed out later. The fact that there is not enough gold to fulfill the promises to pay in gold is so well known to every one that were it not that the human race has worshiped this false god gold for so many generations the mere statement that the promise is false would be sufficient. But the promise still persists and what is more strange it is accepted in

spite of the many, many times that it has been proved to be false. We still give it credence and use it as the basis of our financial system.

Figures serve only to confuse and there are more potent proofs than the mere recital of figures that the gold redemption promise is false. Conclusive proof is based upon what everybody knows to be true—many, indeed, from bitter experience. This proof is the evidence afforded by the panics that have so often occurred, during which payment in gold was demanded but refused.

Other evidence of the fallacy of the gold standard is found in every issue of clearing house loan certificates that has been made.

Clearing house loan certificates were first issued in 1860, owing to a demand on the banks for money. Subsequent issues occurred in 1861, 1863, 1864, 1873, and in 1893. In recent years there have been wide extensions of their use.

In 1907 industry had outgrown the currency system, and to supply the need, over one hundred millions of certificates were issued against four hundred and fifty millions of collateral. These were in public circulation from October, 1907, to January, 1908. In 1914 over two hundred millions of dollars in clearing house certificates were issued, and got into public circulation, in addition to other emergency money issued by the National Currency Association.

We will discuss here the issues that got into circulation, because they afford the most complete proof that the gold standard, with its promise to redeem credit in gold, is fallacious.

From the Comptroller's Report for 1919 we learn that bank deposits in the United States amounted to about thirty-three billions of dollars, while the reserve held against them was just a trifle over one billion dollars. That is, in the richest country in the world, the banks, including the Federal Reserve, has less than three dollars for every hundred they promise to pay. This reserve is sufficient to take care of the demand for payments in money in normal times, but when an abnormal demand comes, it is found inadequate.

Similar conditions existed in 1907. Business failures and other causes had precipitated a panic, which became general. The result was an abnormally large demand for money from the banks—depositors clamored to withdraw their deposits. And there were only about two or three dollars in the country to pay each hundred dollars the banks had promised to pay.

There was only one way out of the difficulty, and the banks took it. They put their credit in tangible form, and in such shape that it looked like money. They issued clearing house certificates, in appearance similar to government issued paper money, and the public accepted it.

In fact they had to accept it. There was no other alternative, for legal relief was impossible. State governors declared every day a legal holiday until the scare was over. As the courts are closed on holidays and as no one could bring an action against a bank the certificates had to be accepted.

Several inferences are possible from these issues of clearing house certificates.

In the first place their issuance was positive proof that the reserve system is founded upon fallacy. Their issuance also demonstrated the immense power of the banking interests. But for the moment we will set these matters aside, to come back to them later, after showing how the events above related prove the fallacy of the gold standard.

Under the gold standard, all credit is supposed to be a promise to pay in gold. A check or draft is looked upon as an order for real money which is supposed to be held by the bank in trust for the depositor. The words on the check make it an order for money. But the money is not there. While there is sufficient money held in reserve to take care of the normal demand for money, the moment the demand becomes abnormal, the system breaks down.

When the abnormal demand of the panic of 1907 occurred, the banks could not fulfill their obligations, *for the money to do so did not exist.* To get out of the difficulty, they presented their credit in a different form, and forced the people to accept this new form of credit as money, at its face value.

While the public was fooled or forced into accepting the certificates it is obvious, among other things, that the very act of issuing them proved that banks were unable to carry out their promises. The obligation of the gold standard, to pay in gold was clearly proved to be impossible of fulfillment.

In fact the greatest concern of our financiers today is: "How can we juggle this promise of gold redemption around so as to keep the people believing in it?" It is

the same old question that bothered the banker's predecessor, the goldsmith. In the chapter on "The Gold Standard" it will be proved by the words of a former Secretary of the Treasury that this question is the banker's principal study.

Were the matter not so serious it would be a joke and there is also a bit of comedy behind the clearing house certificate which savors of the slapstick.

Panic occurred because the public lost faith in bank credit. Perhaps someone realized that the banks were not able to fulfill their promise to pay in gold. For they had in all kinds of money only about three dollars with which to pay a hundred, and so some one became nervous. But our financiers were equal to the occasion. They got together in their clearing house and dished up the same credit in a little different form and the public swallowed it.

No pomp or show of power in this—just a little sleight of hand. Our prince of leger-de-main, the banker, issued bank credit as money in defiance of the law of the land and in the face of public distrust, and the people came away satisfied.

The people were hoodwinked, the infraction of the law was permitted to pass unnoticed, and its soothing effect was mistaken for a real cure; so the same principle was used in the Emergency Currency Act of May thirtieth, 1908, and was later formulated into law by the Federal Reserve Act. Both acts are attempts to escape the consequences of a promise that cannot be fulfilled.

Could anything demonstrate more conclusively the weakness and fallacy of our financial system?

The gold standard which promises that all credit shall be redeemed in gold is a falsehood, consequently our whole system is false, for it is based on this promise. There is not enough gold in existence to redeem even a small fraction of the outstanding credit. Whenever it becomes necessary to fulfill the promise of gold redemption, that promise cannot be fulfilled, and it is necessary to resort to tricks and subterfuge.

Now let us turn to this other phase of the same problem, and look into the fallacy of the reserve system.

To cash depositors and to borrowers alike the banker extends his credit, in the form of a promise to pay money, either on demand, or subject to certain conditions, such as notice before withdrawal.

In order to gain public confidence and in a measure to safeguard the interests of the depositor, the law requires the bank to keep a certain proportion of its deposits in reserve. In some countries the proportion required is left entirely to the discretion of the banker, but in this country it is fixed by law both for national and for most state banks.

The actual proportion required depends upon whether the bank is a state or national bank, and upon whether the deposit is a time or demand deposit—a savings account, or a commercial account. Commercial deposits may be withdrawn at any time, but notice of intention to withdraw must be given some days ahead in the case of a savings account. Most banks, indeed, will pay even savings accounts on demand, if times are normal, and provided the depositor is willing to forego his interest.

The above, in brief, are the factors that control the

proportion of deposits required to be held in reserve. A member of the Federal Reserve System is required to keep in reserve from seven to thirteen per cent of its demand deposits, according to its location, and three per cent of its time deposits. These reserves must be deposited with the Federal Reserve Bank of the district which in turn must keep thirty-five per cent of these deposits (which are reserves themselves), in reserve.

Now this system is workable only so long as times are normal, and there is no great demand for cash—in other words, so long as industry and commerce are in such a condition of confidence that bank credit is accepted without hesitation. But where an average of about ten per cent is all that is kept in reserve by primary banks, and where the Federal Reserve Bank only keeps about one-third of this in reserve, so that in fact only about three to four per cent of demand deposits are kept in the form of a cash reserve, then it is obvious that the moment a demand for payment of deposits that is only slightly greater than normal occurs, the whole system breaks down.

To cover up the gold redemption lie and to furnish, as the Federal Reserve Act says an "elastic currency," that act provides that the thirty-five percent the Federal Reserve Banks must retain as reserve against deposits may be carried in gold or "lawful money." Greenbacks are "lawful money" and it will be shown in a later chapter that the banks may issue about ten billion dollars of credit with no reserve behind it except greenbacks.

In addition the Federal Reserve Act provides that all reserve requirements may be suspended by the Federal

Reserve Board at any time and this provision puts the country on an unlimited paper money or bank credit basis.

If the financiers who framed the Federal Reserve System believed that the promise to redeem in gold could be fulfilled why did they provide these means of avoiding fulfillment?

They knew, as all thinking men know, that the gold standard promise is nothing but an ancient fetish and so in reality they have discarded it.

However, instead of establishing a better system based on truth they still try to cover up the basic falsehood of the gold standard by a complicated system of reserves.

This bit of jugglery has so far accomplished the purpose of deception, but greatly to the detriment of all concerned, as is evidenced by our present slump in business the exact cause for which will soon appear.

The issuance of clearing house certificates, affords proof that the gold reserve is a fiction. Every panic, in fact, was abundant testimony. When banks had to close their doors, when legal holidays were declared to relieve them from payment, when a thousand and one other subterfuges have had to be employed to escape from the promise of gold redemption is it not marvelous that the foolish promise still continues to be the basis of our credit system?

It was formerly the custom of the English Banks, when a run was being made upon them by frightened depositors, to pay in sixpences. The long time required to pay any considerable sum in this shape gave them leeway, and a chance to tide over the critical period until

the panic was over. Such a custom is merely illustrative of many other devices that have been used and always will have to be employed as long as the false idea of a reserve system is maintained.

It is hardly necessary to proceed further in this as the falsity of the system of cash reserves behind deposits is sufficiently clear. Let us now sum up the points we have offered, and proceed further in our search for the cause of our present troubles.

It has been shown, in the first place, that credit, as it exists today, is founded upon a fallacy. The problem was divided into two phases, and the fallacy in each case has been demonstrated. There is no alternative but to accept the truth that our present credit system, and, consequently, our banking system, which controls our credit, is founded upon a lie. It is no "white" lie either, for it causes any amount of trouble.

In order to emphasize this fact let us digress for a moment, and see what are some of the results of this fallacious system.

In the early part of this book an example was given of how the bankers refused to extend credit for an enterprise which would have benefited society and which was, therefore, deserving of credit. And from this fact we reasoned that the banker, by obstructing the fullest progress of industry, had acted against the best interests of society.

At the same time it was hinted that this might perhaps not be the banker's fault.

Let us now take the case of a banker who has extended his loans to such a degree that his cash on hand

and his credit with the Federal Reserve are only sufficient to cover the reserves required to be held against deposits.

Then, although the project above mentioned were deserving of credit, and although good security were offered and the banker wanted to make the loan he could not grant it, for he would not have any cash to hold or funds to deposit with the Federal Reserve Bank as a reserve against the deposit that the loan would create.

In other words the bank has arrived at its limit. It has let out all the credit that the reserve requirement will permit.

For instance take the little bank we started business with at the beginning of this book. It had in cash from the sale of its stock and from deposits $60,000, and it was required to keep a 10% reserve which means that it had to have 10% of its deposits in cash or on deposit with the Federal Reserve. So this little bank could have $600,000 in deposits. As was shown all but $50,000 of these deposits or $550,000 was created by the bank making loans. Now, when a bank arrives at this point, unless it gets in more cash or paper that it can deposit with the Federal Reserve, it can make no more loans without exceeding its reserve limit. When a bank's business reaches this state it must refuse to make loans. Its credit is no longer "liquid"—it has arrived at the zero point where bank credit "freezes."

Although we hear much of "Frozen Credits" today the objection may still be made that we are here taking an extreme case, and one that does not often exist. The answer to this, if any be required, is that the banker's

fear of going too near the margin of his reserves, has a similar effect, so that even in cases which are not so extreme, there is the tendency to refuse loans where loans should, in the interests of industrial progress, be extended. Consequently, there is the tendency to hamper progress.

The extreme case is selected for illustration, because it shows the matter in the clearest manner, but the tendency is there and has a very strong influence whether the case is an extreme one or not.

It becomes clear then that credit "freezes" because it is based on gold and that "frozen credits" which are the cause of our present business slump are in reality "guilded credits." That is the gold redemption promise is the element that causes bank credit to freeze.

Now it is also clear that credit is necessary to trade and since trade creates industry, as credit freezes, so industry slows down. This condition makes our present system very awkward, for since prosperity increases the demand for credit, the more prosperous business becomes the quicker bank credit freezes for the sooner it arrives at the zero point set by the reserve.

So, as long as we continue a financial system where credit is based on reserves, prosperity will always check prosperity.

It is akin to the automobile previously referred to with the reverse gear where the high speed should be. If you can imagine yourself trying to operate or even ride in such a machine you will have a mental picture of our present social system and will understand the cause of its worries and disappointments. As soon as business

speeds up a little the "reverse gear," that is the reserve requirement, gets in its work and back we go.

Succeeding chapters will show how this "reverse gear" may be removed or in other words how to do away with the false promise of gold redemption which causes bank credit to "freeze." When we perform the slight operation suggested prosperity will return and it will be continuous.

Now in addition to showing clearly one of the harmful effects of a false system of credit, the foregoing illustration gives a hint at the fault that lies behind all the other faults, and which must be taken into account before a remedy can be devised that will really be a remedy.

Briefly, the banker could not, in the above case, extend the loan, because, although the security offered was good, it was not a liquid security or a form of security required for rediscount at the Federal Reserve.

In the development of commerce from barter to exchange by means of money, a few commodities, and finally only one commodity, came to be chosen as the medium of exchange.

In the development of exchange by means of credit, the superiority of this one commodity—gold—was not assailed.

But commerce has now outgrown credit based on one commodity, and requires a system of credit based on all commodities of value and one which will always have a full measure of public confidence.

But before we discuss the remedy, we must see clearly what must be remedied. We will continue, therefore,

with our inquiry into the defects of our present system of exchange.

In discussing the issue of clearing house certificates, we stated that those issues which got into public circulation afforded a powerful instance of the immense power of the banking interests.

In issuing these certificates, and allowing them to get into public circulation, these interests committed an infraction of the law, and escaped unpunished.

The Constitution reserves the right—"to coin money" —to the Federal Government. Money is the medium of exchange, and clearing house certificates became part of the medium of exchange while they were in public circulation. There was no legal sanction to the issuing of those certificates, and in issuing them, therefore, the clearing houses, and through them the bankers, infringed the law.

Now there is no doubt that the expedient of issuing those certificates prevented further disaster, but this does not lessen the fact that it was an infraction of the law. And it is perfectly obvious that no lesser power than the banking interests would have been permitted to justify an infraction of the law by the plea of expediency.

That they were allowed to do so, therefore, and escaped unpunished, indicates the extent of their power.

We have had many evidences of the existence of a hidden power which is superior to government authority, but probably no occurrence has ever pointed out more distinctly the extent of this power, and at the same time the exact source from which it springs.

And furthermore, the plea of expediency is in itself an indictment of the system which makes such an expedient necessary. For the plea of expediency implies that the method resorted to was illegal.

Would anyone be disposed to deny that a system which requires the use of an illegal expedient to avoid the harmful results of its inadequacy is a faulty system, and therefore one which should be revised?

Here we have at one time an illustration showing that our medium of exchange is entirely inadequate to perform the service required of it, and also a glimpse of the tremendous power the group which controls it has acquired.

These, then, are the faults of our present medium of exchange.

Primarily, it is in the control of private interests, who can determine its amount, and whose control inevitably tends toward a restriction in volume, so that industry is continually hampered and every period of prosperity is invariably followed by a period of contraction in the medium of exchange resulting in depression of business.

Secondly, the medium of exchange, as it exists today, rests upon a false foundation, one that is too narrow, one which, although usable during the earlier stages of the development of bank credit, has become outgrown, and, lastly, one which contributes to the destructiveness of the private control of bank credit.

This foundation is the gold standard, under which all credit is based upon gold, and the medium of exchange is supported by a gold reserve rather than by sound credit based on real value.

The whole purpose of this discussion has been to point a way to a remedy.

Now that we see clearly where the present system falls short, and where it is necessary to apply correction, we can understand what features the remedy must possess, in order to satisfy the present demands of commerce.

We are consequently now ready to proceed in our search for an improvement which will do away with these shortcomings in our financial system and which will not only restore the country to a condition of prosperity but which will permit prosperity to continue.

But there is another point that we must bear in mind, and that is to make the remedy practical. We must take things as they are today, and devise a means which, while effectual in abolishing the trouble, does not necessitate such wide-sweeping changes as to be practically impossible of application.

We cannot reach far without standing on the shoulders of our predecessors, and we, therefore, should seek to preserve the good qualities of the present order, while modifying it only so far as is necessary to eradicate the shortcomings. In this way only can a practical and permanent change for the better be hoped for.

With this in mind, our next step is to inquire more closely into what might be called the philosophy of money—to see exactly what the nature of our medium of exchange is, what place it should fill, and what its functions should be. Then we may proceed to our inquiry as to what actual measures must be taken to modify the present system in such a way that our exchange medium will fulfill its proper functions.

Then the next step after that, the last step, will be to suggest the actual means by which these measures can be practically applied to our present system and finally we must show that they accomplish the desired result.

CHAPTER VI

A PERFECT EXCHANGE SYSTEM

IN ORDER to determine what sort of medium of exchange would best be suited to existing conditions of modern industry and commerce, the first step is to gain a definite idea of the proper functions of a medium of exchange.

For this purpose let us first of all make a distinction which, while somewhat arbitrary, may help us to obtain a better understanding of the subject; that is the distinction between money and the medium of exchange.

Money is a measure of value, while the medium of exchange is the means used to transfer the ownership of goods and to compensate services.

In order to make this distinction clear, let us compare the conceptions of value and length. Both value and length express a ratio between different objects. We say, this is longer or shorter than that, and, this is more or less valuable than that. And in order the more easily to compare the length of different objects, an arbitrary table of standards has been fixed. A certain absolute length is called a foot. One-twelfth of this length is an inch. A length equal to three feet is a yard.

A similar table of standards is made as regards value. In the United States this money table for measuring value is as follows:

Ten mills make one cent.
Ten cents make one dime.
Ten dimes make one dollar.

And just as a certain definite length was arbitrarily set and called a foot, so was it also intended that a certain arbitrary amount of value should be called a dollar.

In itself, then, money is not value, but the measure of the exchangeable ratios between various goods and services—that is, money is the measure of value.

What the foot is to the measure of length, the dollar is to the measure of value. The foot is that unit in which we express length and the dollar is the unit in which we express value or price.

In order, therefore, to determine what are the qualities essentially required in an ideal medium of exchange, it is necessary first to determine exactly what are the functions of money. Having determined this, it is then possible to proceed and determine what qualities a medium of exchange should have in order to fulfill those functions in an adequate manner.

The object of transportation is to add value to goods by changing their location; the railroads are one of the most important factors in carrying out this object. Similarly, the object of money is to add value to goods by facilitating a change in their ownership, so that they will be owned by someone to whom they are worth more; this object is carried out by means of the medium of exchange.

Just as the ideal transportation medium is the medium which will change the location of goods, whenever neces-

sary, with the least possible effort and trouble, so the ideal medium of exchange is the medium which will change the ownership in goods with the least possible friction, trouble, and loss, and whenever necessary.

The medium of exchange, then, is not an end in itself, but only a means to an end. It is a means by which people may exchange what they have for something which they are more desirous of having.

This exchange could be made directly, by means of bartering one goods for another, but at best barter is a very cumbersome and unsatisfactory method. Exchange carried on by barter is practiced only in the early stages of civilization. Even the smallest advancement in civilization requires some sort of a medium of exchange in order to carry on trade.

People, therefore, are interested in getting money for what they have only in order that they may get what they want at some future time in exchange for whatever they accept as money.

Immediately we see one essential requirement of any medium of exchange, acceptability. People will not give up their goods for a medium unless they are sure that in turn they can get in exchange for that medium what they want. They must feel sure that other people will accept from them the medium of exchange in return for the goods they have to sell.

"Safety First" or confidence then in the medium of exchange is the first necessary requisite.

Furthermore, people are interested not only in getting something in exchange for what they give up—they are interested also in getting an equal amount of value and

having what they get retain its value. Here we have the element of time.

Some time must elapse from the moment when a person gives up the goods he possesses—or the services he renders, his labor—in exchange for a quantity of the medium of exchange, and the moment that he uses it, or a part of it, to purchase the goods he desires. This time may be longer or shorter, but irrespective of its length, it is essential that the medium of exchange shall not shrink in value while it is in his hands.

The reverse is also essential—the medium of exchange must not swell in value. For while this would benefit the person who possesses a quantity of the medium of exchange, it would work just as great an amount of harm to some other person who is not holding the medium of exchange, and who finds it more difficult to obtain the same in exchange for his goods.

These then are the two essentials of the ideal medium of exchange. The people must have absolute confidence in it, so that it will be accepted by everybody without question. This condition prevails only when everybody feels quite sure that he will be able to get what he desires in exchange for it.

And secondly, it must have an absolutely stable value. The dollar must not grow larger or smaller.

Think of what would happen if the standard of other measures should fluctuate.

Suppose the yardstick were shortened one inch. Then the creditor who had due him ten yards of cloth would lose ten inches. And on the other hand, if the yard stick were lengthened one inch, the creditor would gain ten

inches this time, but the debtor, the man who had to hand over ten yards of cloth, would have to hand over a length equal to ten inches longer than he had bargained to hand over. The debtor in this case would lose ten inches of cloth, or an amount of value corresponding to the value of ten inches of cloth. Think of the havoc and confusion such an occurrence would give rise to.

And this is precisely what does happen to the measure of value.

Commercially, value is price. The exchangeable value of anything is its price. If we shorten the value measure prices go up for it takes less goods to equal a certain sum and if we lengthen the value measure it will take more goods so prices will go down. An example will make this clear.

In the early days of colonial Virginia the colonists, for want of coins of precious metals, used tobacco as a medium of exchange. When the tobacco crop was large, the volume of the medium of exchange became inflated, and it took more tobacco to buy a bolt of cloth, a keg of rum or a sack of potatoes than it did when the crop was normal. In other words, a heavy crop of tobacco meant that prices would be high. This favored the debtor for it shortened the measure of value and thereby reduced the amount of goods or services he must render to pay his debts just as the shortening of the yard stick would reduce the amount of cloth the seller would give for a yard.

Conversely, when the tobacco crop was small, the volume of the medium of exchange contracted, and the same articles could be bought with less tobacco. A bad

crop of tobacco meant low prices or the lengthening of the measure of value.

Tobacco, although a clumsy medium of exchange, in principle is not different from gold and silver, which are mined in unequal quantities yearly.

It was the discovery of gold in Alaska and the consequent enlargement of this medium that allayed the free silver talk of the nineties, not any law passed by Congress. Increase in the volume of gold brought down its price, and relieved the evil of contraction and low prices.

In the above discussion, by prices we mean the general level of prices, or the purchasing power of the dollar. A change in the general level of prices is in reality a change in the value of the dollar and such a change is just as great an evil as a change in the measure of length would be. It is a change in the value unit and is analogous to a change in the length of the yardstick.

When a man exchanges his goods for any medium of exchange, his only concern is that what he receives shall be accepted from him at the same value measured in dollars and cents.

A stable value for the dollar does not mean that individual prices should remain constant. We have no right to ask that a given amount of the medium of exchange shall exchange for the same amount of flour or clothing or labor the next year as it does this. Individual prices of individual commodities must be determined by the demand for and supply of the particular article or service.

The sole object of any medium of exchange is to

keep track of credits. It is a system of book-keeping, and the book-keeper should be on the square, so that a given credit shall mean the same thing from one time to another.

The unit of value—the dollar in the United States, should transfer the same amount of value at all times. The amount of value commanded by the different commodities may vary, and must vary, with changing conditions of supply and demand of those commodities, but the amount of value which the dollar measures must be expressed in unvarying units.

Value is divided into fixed units only for purposes of comparison—in order that we may compare the worth of one commodity with that of another—and of what use are those units unless they mean the same thing at all times the same as do other measures? The value of the dollar must not fluctuate. That is, the average price level must remain constant.

This is in nowise affected by the substance out of which the measure of value happens to be made. There is no more need to make an eagle out of gold, a dollar out of silver, and a cent out of copper, than to make a yardstick out of gold, a foot rule out of silver, and an inch measure out of copper.

We are interested in the thing measured and not in the measure itself. Convenience is the only rule to be followed here.

These then are the two requirements which the ideal medium of exchange must possess: confidence, or unvarying acceptability, and stability, or unvarying value.

The value or price of the dollar depends upon two

factors and their relation to each other. These are, the volume of the medium of exchange—the number of dollars in circulation—and the volume of business transacted by that medium—the number and amount of the exchanges which those dollars must effect.

Convenience alone dictates the actual relation between these two, that is, the number of dollars which are best adapted to effect the exchange of a given amount of value, but once this relation has been set, it should remain fixed, and not fluctuate, as it does today.

The fluctuation of this relation—the number of dollars to a given amount of value—occurs only because the medium of exchange does not vary hand in hand with variations in the volume of business.

As we have already seen, if the volume of business increases while the volume of the medium of exchange remains unchanged, then each unit of the medium of exchange, each dollar, will have to exchange a larger amount—will have to do more work. Prices will go down, that is, the price of money will go up. The value of the measure of value has increased, and the results are analogous to the results of an increase in the length of the measure of length. When the dollar stretches it takes more wheat to make a dollar's worth and if the yardstick would be stretched it would take more cloth to make a yard. If the volume of the medium of exchange was normal before the volume of business increased, then it is insufficient now, and the community is suffering from contraction.

The very same thing happens if the volume of business remains the same and the medium of exchange shrinks.

Inflation, as we have seen, has the opposite effect. It is the result either of a decreased volume of business with the same volume of the medium of exchange, or of an increased volume of the medium of exchange with an unchanged volume of business. Its effects are similar to those which would follow if we squeezed the yardstick down, so that it became shorter. The value of each unit, each individual dollar, decreases, and the general level of prices increases.

Inflation raises prices and deflation lowers them. This change occurs without any change in the supply of or demand for the various commodities other than as the demand is affected by the volume of money. It really is not that the prices of any commodities have changed, but that the value of the dollar has fluctuated.

And now we see that the only way to stop the dollar from fluctuating in value is to tie the medium of exchange in such a way to the volume of business that the two will always vary together.

If the volume of business is cut in half, the volume of the medium of exchange will then also be cut in half, and a single dollar will express the same amount of value as before.

And if the volume of business doubled, then the volume of the medium of exchange would be doubled, and a dollar would still be worth just as much as, and not more than, before.

We require a medium of exchange, then, that is elastic, and, furthermore, this elasticity must be governed by the volume of business, so that the relation or ratio between the volume of business and the volume of the

medium of exchange shall always remain the same. When this is done, the value of the dollar will not fluctuate.

An apparently natural question that would arise at this point is, what volume of medium of exchange is suited to a given volume of business? What amount of money is necessary to a community?

Economists in the seventeenth century attempted to answer this question in definite terms.

For instance, Sir William Petty set the amount of money necessary as one half the rent of land, one fourth the amount of the building rent, and one fifty-second part of the annual wages of labor—this last indicating that wages were paid weekly on the average.

The philosopher Locke's view was that the amount of money necessary in any community was one-fifth of the laborer's wages, one-fourth of the land owners' revenues, and one-twentieth of the traders' yearly returns.

Modern economists have had the good sense not to venture a guess at this question, which in fact, is an unanswerable one.

But while no attempt is made by modern writers to fix the volume of the medium of exchange required for business the idea still persists that there is some fixed ratio or amount. The idea shows itself in such expressions as, "Business will revive when we get back to NORMAL," "Good times will return when prices come to NORMAL," "NORMALCY will bring prosperity," etc.

All such expressions suggest that the user believes there is a normal condition to be reached under our

present system. That is they suggest that there is a certain fixed volume for our medium of exchange or at least that there is a certain fixed ratio between the volume of business and that of the medium of exchange.

If there ever was or could be such a ratio it is evident that it is impossible of attainment under our system so long as it is based on a fictitious reserve and is privately controlled. The truth of this statement should be perfectly apparent for it has been demonstrated beyond question that under our present system the volume of the medium of exchange controls the volume of business. When the private control lets out credit and allows business to get into a prosperous condition the demand for credit increases and runs bank credit up against the reserve, the "freezing" point, and "Frozen Credits" cause a slump. Consequently our condition is never normal and never can be so long as these defects remain. The fever of prosperity produces the subnormalcy of slump. So we are always looking for "NORMALCY," meaning a condition of peace and good will, but "NORMALCY" never arrives. Our exchange system makes our normal condition one of uncertainty, worry and turmoil.

A normal condition, however, can be reached when by public control we tie the volume of the medium of exchange to the requirements of business so that the demands of business will control. Then normalcy will arrive, for if the medium of exchange were placed under such conditions the volume would take care of itself, it would be automatically regulated to the correct amount, being neither more nor less than necessary and the dollar would not fluctuate in value.

Since the medium of exchange is only a means to an end and not an end in itself—the end being to facilitate trade, that is to permit one to obtain what one desires in return for what one has, the simplest medium of exchange would be one from which all concrete attributes were taken away.

That is to say, it would be merely a process or system of book-keeping, and entirely abstract.

Whoever sold anything would receive from the purchaser his I. O. U. for the amount of the price. Whoever bought anything would give his I. O. U. to the seller for the amount of the price. These I. O. U.s would be sent to a central clearing house, where those taken by any particular person would be cleared against those given out by that person, and the balance would be charged or credited to him according to whether the amount of those received fell short of or exceeded the amount given out.

This arrangement would be an ideal financial system. By such a system the facility for exchanging goods and services would be practically perfect. The medium of exchange would be perfectly elastic, for its amount would vary in exact proportion to variations in the volume of business. Such a system would allow perfect freedom in the exchange of goods and services, and would not control or hamper trade and production.

But, while such a medium would fulfill one of the two necessary requisites of an ideal medium of exchange, it would not satisfy the other. It would answer the need of stability by proper elasticity, but it would not fulfill the need of confidence.

The illustration is founded upon a false assumption, the assumption that every one is honest and capable of fulfilling every obligation, and that every one knows that every one else is honest and capable. In other words, it assumes one hundred per cent confidence in one another among all the individuals of the community. This is a false assumption, since the human race is not invariably honest, and probably even less capable of fulfilling every obligation. The entire supposition, therefore, is false, and such a financial system could not be instituted.

The system is at one extreme. It satisfies one requirement, the requirement of stability in value, but it falls entirely short of the other requirement, that of confidence.

The metallic system is at the other extreme, it fulfills the requirement of confidence, but does not fulfill the requirement of elasticity, and consequently of stability.

The metallic system is one in which certain metals form the medium of exchange. Such a system would exist if gold alone formed the entire medium.

Owing to its scarcity, and universal desirability, gold possesses something in the nature of an intrinsic value, and this quality gives to it the necessary requirement of confidence. But the other requirements of elasticity and stability, would be absent, in a metallic system. For, as was shown in preceding chapters, the quantity of the metal does not vary with the variations in the volume of business. On the contrary, as commerce and industry increases, the production of gold tends to decrease.

The metallic system then is at the other extreme. The requirement of confidence is fulfilled, but the requirement of stability through proper elasticity is not fulfilled.

Let us now examine the medium of exchange which we actually do use, bank credit, in order to determine what requirements are necessary to make it a better medium.

The requirement of confidence is partly fulfilled, for people to a great extent are willing to accept bank credit in return for their goods. But it is only partly fulfilled, a fact which is at once illustrated by the necessity for keeping monetary reserves behind bank deposits.

The requirement of elasticity is also partly fulfilled by a complicated system of reserves, for the volume of bank credit can be increased or decreased without entire reference to any particular commodity; but this is only within certain limits, partly because it is still tied to one commodity—gold.

Upon examination it appears, however, that our present medium of exchange is not essentially different from the ideal arrangement mentioned, where perfect confidence was assumed, and personal I. O. U.s were the medium of exchange.

The chief difference is that, not having entire confidence in one another, our I. O. U.s, instead of being used directly, are traded for the banker's I. O. U., in the form of a bank credit or deposit, which is transferred back and forth among us by means of checks.

It does not necessarily follow that the banker is any more honest or capable than any other individual in the

community, but the increase of the banking habit has made his credit better known, and our banking laws have promoted public confidence. Therefore, bank credit is more acceptable than private or personal credit.

Bank credit, then, fulfills both essential requirements, to a limited extent.

By this limitation, bank credit falls short of being an ideal medium of exchange, as it is constituted today.

But this does not necessarily prove that bank credit could not be made the ideal medium of exchange. In fact, it points rather to the opposite conclusion.

Since it possesses both qualities to a certain degree, it is probable that a proper means of creating and using this medium of exchange would make it an ideal medium.

This conclusion is still further strengthened by the fact that the reasons for its limitations are not reasons necessarily bound up with the medium itself.

For instance, the reason why bank credit, as we have it today, does not fluctuate in volume with variations in the amount of business activity, is because the control of the volume of bank credit is in private hands, and because it is based on a false standard,—gold convertibility. Neither of these faults are inseparable from bank credit, and consequently these bad qualities can be exchanged for qualities that will enable the volume of bank credit to fluctuate according to the needs of business.

The problem, then, is comparatively a simple one. No radical change is necessary. The present system needs but slight alteration and reformation in certain features in order to give us the ideal medium of exchange.

The alterations required are such as will, in the first place, put one hundred per cent confidence behind bank credit, and in the second place, take the control of its volume out of private hands.

It must be issued so all will know it is safe. Control must be placed where variation in volume will be regulated by business activity, so that at no time will there be too little of the medium of exchange in circulation, and likewise never too much, but always the exact amount required for the needs of business.

Bank credit is no different from any other credit and consists of confidence and time. The greater the confidence the longer the time.

One hundred per cent confidence is confidence which will extend for practically an unlimited time. This confidence the present financial system lacks, as is shown by the 30, 60 and 90 day limit placed on bank loans. It is the lack of public confidence in the bank that causes this lack of time in bank credit and prevents our banks from carrying the long time credits necessary for agriculture and foreign trade.

A practical remedy must supply the 100% confidence necessary for the perfection of our medium of exchange. Then reserve requirements, the gold standard, and all similar makeshifts used for the purpose of holding confidence would disappear, and the banks could carry any good credit for any length of time.

All good securities would be liquid assets. They would be bankable securities. Industry would no longer suffer from short time credits or from periodical setbacks, because credit had frozen up. The cause of "Frozen

Credits," "Buyers' Strikes" and recurring periods of depression would then be removed and progress and prosperity would go ahead without interruption.

The other part of the problem is to ensure the proper variation in the volume of the medium of exchange, so that expansion and contraction of the medium will not affect the value of the dollar but will occur only as business expands or contracts and industry will be allowed full swing.

Both these objects can be accomplished by taking bank credit, the medium of exchange, out of private hands and putting it under the proper public control.

The next step then is to show how this can be done in a practical way.

CHAPTER VII

100% SAFETY AND ELASTICITY

NOW that we have come to a point where we can seek to apply a remedy for the situation, we see that the problem is a double one, that it has two parts.

In the first place, it is necessary so to tie the volume of the medium of exchange to trade and industry that it will correspond to variations in the volume of business. This regulation is necessary in order to stabilize the value of the dollar and to provide a constant general level of prices.

Secondly, we have the problem of gaining and holding full public confidence in the medium; so it will be readily accepted by all.

The system must be such that everyone will know that he in turn will be able to get rid of the medium of exchange in payment for what he wants; without a shrinkage in value.

In short, the medium of exchange must be such as will possess stability through proper elasticity, and safety through full confidence.

With regard to the first requirement, we see that it is based, of course, upon the method in which the medium of exchange comes to vary in volume, and we see that, since bank credit is our medium of exchange, and the banker has full power to extend bank credit or withold

it, the variations in volume are today entirely in the hands of the bankers.

Since the power to refuse or to grant a loan determines the volume of the medium of exchange, the elasticity of that medium depends upon this power.

We have here the kernel to the solution of one part of our problem. This power, to grant or refuse a loan, must be so placed that it will operate only when business demands it. It must operate so that the medium of exchange will always be there for use when trade and industry demand it. The question of whether a loan should be granted or refused should be answered only by the demands of business in such a way that the medium of exchange will vary in volume directly as the amount of business offered may vary.

As begins now to be clear, and, as will be shown more forcefully very soon, the arrangement necessary to accomplish the desired end, involves the taking of the power to decide loans out of private hands.

Confidence in bank credit depends upon the security behind the loans made by the banks and, therefore, the methods used in granting loans determines the amount of confidence or safety in our medium.

When people know that there is full value behind any medium of exchange, then they are willing to accept it at full value.

When they do not know whether or not there is full value behind it, they are always in fear of it or they will accept it only at a lesser rate, depending upon the degree of certainty or uncertainty.

This lack of knowledge as to what is behind bank

credit is the reason why, when anything occurs to shake the confidence of the people, they rush to withdraw their deposits from the banks. They feel uncertain as to the value behind their money in the form of bank deposits, or bank credit, whereas they always feel perfectly certain about the value of gold.

It follows, from the foregoing, that if people could be made to feel quite certain that there is full value behind every dollar's worth of bank credit demand would never be made for payment of bank deposits in money. The people would accept it at full value without fear, and panics and bank runs would be abolished.

With one hundred per cent confidence in bank credit gold reserves and in fact no legal reserves would be necessary.

The remedy involves, then, the substitution of a more logical security than the promise to pay gold as the value behind the medium of exchange in circulation.

This security must be of such a value as will bring with it absolute, one hundred per cent confidence in the medium, so that it will always be acceptable. People must never feel doubtful as to the likelihood of their getting value in return for it.

These principles then, are the general points that are to guide us in fitting the remedy to the conditions requiring reform.

For greater convenience in proceeding, we may divide the process of creating the medium of exchange, bank credit, into three steps or phases.

The first phase is, whether the credit shall be created or not, whether the loan shall be advanced or not.

The second step is the appraisement of the value of the security offered for the loan.

The third step is to determine what percentage of the appraised value can be safely loaned against the security.

These demarcations are not very important in themselves. All the steps are always present in making a loan, but they are not clearly marked off from each other. However, owing to the greater ease and simplicity of dealing with the problem in this manner, we may follow the demarcation, keeping in mind that it is neither a very pronounced nor a very important one.

Our present method of issuing bank credit is as follows:

When a person applies to a bank for a loan, the first thing the banker does is to appraise the security. Since this is the customary order, we will discuss this step first.

In the case of personal property the value is easily ascertained from market reports or discount sheets, but in many cases an appraisement of real property is but a guess at the value, and a one-sided guess at that. Not only does the result depend upon the banker's limited information, but his self-interest, personal friendship and prejudices, may also enter into the transaction. In fact some loans are made without security. The public knows that these conditions exist and, consequently, the people cannot have full confidence in the medium of exchange that is created by the loan.

Here, then, we see the first particular need of reform and that is in the matter of appraising the value of the security offered for the loan.

At this point we may recall the banker's set formula,

"The security is good but not bankable." Our first step is to ascertain just how good the security is and this must be determined in such a way that every member of the community will accept the appraisement of the security as being the true value.

Our system must be such as will determine the true value of every kind of property, both real and personal, and the method used must be such as will impress the people with the fact that it is the real value. Every member of the community must accept and believe in every security and every good security must be a bankable security.

The farmer's land, the merchant's goods and the bond holder's bonds, must all be equally "liquid" and all equally acceptable as security for a bank loan; the percentage of the loan to the value depending on the stability of the value of the security offered, that is on the fluctuation in its price.

Now it so happens that we already have two separate systems of public appraisal which cover all property. With a slight and simple change in one of these systems they both become excellently adapted to the appraisal of securities offered for bank loans. And at the same time by the change in one of these systems it will operate all the more satisfactory in its present field.

Practically all personal property such as stocks, bonds, wheat, cotton, leather, etc., is appraised every day by sales on the various exchanges or in the markets where such goods are handled. The actual value is established daily and the price is published so this system needs no revision.

And, as every taxpayer knows, the machinery for the public appraisement of all private property operates throughout the country. All private property is appraised for taxes by the public assessor. It is true that this system at present has its faults. In some parts of the country it is laxly or unfairly regulated and administered. In others, however, it is carefully handled. With a slight change in state laws, which will place no added burden on the taxpayers, the assessor's records can be made to serve with entire satisfaction in the appraisal of securities, not otherwise appraised. And what is more, these records will on that account become the more accurate and satisfactory as a basis of taxation.

It is obvious that, at present, it is to the personal interest of the tax-payer to have as low a valuation as possible placed upon his property, since a low assessment cuts down the amount of taxes he has to pay. And even though he be perfectly honest, the desire to save taxes will nevertheless have a tendency, even if an unconscious one, to make him lower the valuation.

Precisely the opposite is the case, on the other hand, when the property holder is seeking to obtain a loan from the bank with the same property as security. Then his interest is to make the valuation as high as possible, thereby increasing the loan that he may negotiate upon it as a basis.

It follows then that if the same appraisal is used to determine the value of property both for one purpose and for the other, the two conflicting tendencies will operate against and so neutralize each other.

In consequence of this conflict the very force of self-

interest will be the cause of a just valuation. For as a tax-payer the property-holder will seek the lowest valuation, and as a person desiring a loan the same property holder will seek the highest valuation. Where one valuation is made to serve for both purposes, the conflicting tendencies will counteract one another, and a fair or just valuation must be the result.

The tax laws generally provide that property shall be assessed at its "true value." At present the value of property for tax purposes is set arbitrarily by the assessor, and is subject to revision only by a board of equalization.

This method of appraising property is fully as reliable as the method of appraisement used by a bank. However, in neither case is the true value arrived at. Both systems are based on the opinions or guesses of a few men, whose views are often colored by prejudice, personal interest, and favoritism.

A system for the appraisal of securities for bank loans must be entirely beyond the reach of any personal interest or human weakness. Guess work and prejudice must be overcome and it must be made apparent to the whole community that the true value has been determined.

Now, as we have just seen, if valuations given on the tax-rolls were made to serve as valuations of security for bank loans, tax-payers and borrowers, caught between their conflicting interests, would strike a mean, or true, value. Over-valuing the property would secure no advantage to a borrower, for the banker would insist on cutting down the amount loaned—the percentage of

the loan to the value. The net result of over-valuing then would only tend to a loss for the property owner through increased taxes.

Under-valuing would cease also, for since the tax rate is fixed by dividing the amount to be raised for government purposes by the whole amount on the assessment roll, under-valuation would be of no advantage to the community, for it would result only in raising the tax rate and would not affect the amount paid as taxes.

Assessment values mean comparatively little today but, if those values were to become the true value and were accepted as such by the banks and the community it would be a very different situation. Comparison of value is so easy that the boosting of value by the would-be borrower and the under-rating of the tax evader would cease.

The effect of the slight change suggested would be very far reaching. It would compel honesty and square dealing. Personal interest would force the community as a whole to give its support to an honest valuation of all property for all purposes.

It is a matter of common knowledge that there is no system of appraisement in use today which can be relied upon to give the true value of real property for any purpose. However, by a slight change involving no expense, the tax system of any state can be made to determine the true value on every piece of property both for tax and security purposes.

Self interest operates automatically so the result of all the interests in the community operating at once would give an impersonal or automatic result.

The legislation necessary to establish a system which would secure an automatic appraisement acceptable as a basis for loans is quite simple.

Existing law provides that an aggrieved taxpayer may submit his grievance to the board of equalization and review for adjustment. However, the result of an appeal to this board at the present time is seldom satisfactory, and if the complainant succeeds in getting the relief sought it does not accrue to the benefit of those who do not complain. Justice is consequently not attained.

But were a law adopted which would make the assessed value of a property also its security value, the uncertainty and injustice in our present method of levying taxes would be rectified. Personal interest, as we have seen, would soon fix the true value of every property.

The assessor today is placed in a peculiar position. The law says he must assess all property at the "true" value, but taxpayers are always seeking low assessments, and there is no way to determine the true value, so the assessor while in a difficult position exercises a more or less arbitrary power.

The assessor's difficulties as well as his arbitrary power can both be done away with by giving the taxpayer a right to appeal from his assessment and also from the decision of the board of equalization. A practical method of hearing this appeal and deciding the question will be shown later. And what is still another good point about this suggestion, the change that would have to be made necessitates only a trifling one in existing law, and involves no dangerous experiment. The only radical

thing about the whole affair would be in the result, which would be a very radical change for the better in all conditions affected.

Let us suppose that a law were enacted making the assessed value of every property also its value as a security, and a taxpayer then felt a grievance over the assessment—he felt that an incorrect valuation had been placed upon his property, either for the purpose of paying taxes or of securing a loan, that is, he thought it was assessed either too high or too low.

The legal remedy now would be to appeal from the assessor's decision to the board of equalization and review for relief. Under the methods in use today the relief, if any, obtained from this board is seldom satisfactory but, with a slight change in existing law, perfect satisfaction could be assured. The true value of every piece of property for both tax and security purposes could be obtained with little trouble.

Give to every taxpayer the further right to appeal from the decision of the board of equalization and review. Then pass a law authorizing the clerk of the board of equalization to subpoena witnesses, call jurors and conduct hearings. Then if the board's decision should fail to satisfy, the aggrieved tax-payer or applicant for a loan he would have the right to appeal from the board's decision and have the value of his property fixed by a jury.

Only those especially qualified should be eligible as jurors. If personal property is to be appraised this qualification should include only such as are well versed in the value of the kind of property in question. In

the case of real property, it should include only those who own property of the same kind, or similar property in the neighborhood. A two-thirds verdict of such a jury of arbitration would settle the dispute.

The right to submit all questions of assessment to such a jury would entirely overcome all arbitrary power of the assessor and completely do away with the present inefficiency of the board of equalization. Without doubt the decision of such a jury could be relied upon, because the jurors, being property owners themselves, would be deciding the value of their own property by their verdict. Self interest would dictate the verdict.

The owners of similar property, who did not want to sell their property or borrow money on it, would naturally favor a low valuation in order to cut down their taxes; while on the other hand, those who did want to sell or borrow would be inclined to favor a higher valuation.

Again, we have a conflict of personal interest, and once more the result of this conflict would be a more just valuation.

This conflict of personal interest among the jurors would compel a compromise in the verdict such as would result in showing the true value of the property. It would, consequently, be a guarantee of justice to all, both to borrowers and taxpayers. Taxation and loans would both be on the "True value."

Here, then, we already have the machinery for appraising property which, with only a few slight changes, could be used most satisfactorily in obtaining a proper and just valuation of all property. It would supply a

long felt want for reliable appraisement for all purposes, especially for real property.

And the publicity of this appraisal, together with the acquiescence of the public in its result, would cause entire public confidence to be placed in the medium of exchange, the bank credit, which would be created as a result of the ensuing loan.

While this method of appraisal would apply more particularly to real property, we have another system of machinery, as previously stated, already in operation which would continue to determine the valuation of most personal property. The values set by it would be accepted just as they are now.

It is a matter of common knowledge that the price of practically all property, except real estate, is set every day in the various central markets such as the stock exchange, cotton exchange, wheat pit, and the wholesale and packing house districts. These prices are printed daily on the financial pages of every metropolitan newspaper and are generally accepted by the banks and everyone else as the true value.

Prices of manufactured products are to be found in the price lists and discount sheets of manufacturers and jobbers.

For all personal property, therefore, there would be little need to institute an assessment, board of equalization and a jury to fix a valuation. We already have a system of machinery which fixes the true value of such property every day. Under our proposed system we would take these valuations as the security-value for bank loans, the same as they are now taken.

At present these values are affected by the contraction and expansion of the medium of exchange but, since our remedy would entirely do away with the fluctuation of the value of the dollar due to such phenomena, the value of all property would then be much more stable.

It is very probable that the need for appraisals of real property by jury would also soon diminish. In order to settle real estate values, several arbitrations in a neighborhood might at first be necessary, but they would result in the establishment of stable values which would change but gradually.

The provision which requires the jurors to be specially versed in the value of the kind of property under discussion, or to be owners of similar property in the same neighborhood, would secure the best judgment of the community as to value. Afterwards established values would be constantly checked against sales and net incomes.

The method of appraisal suggested here as applied to real property, would be extended so as to cover all property, not at present valued in a satisfactory way. This method of appraisement, by opposing the personal interests of the whole community to the personal interests of the individual, makes itself proof against individual favoritism. It rests upon the solid rock of the self-interest of the majority, and consequently the system would work automatically.

In this way the desired result would be obtained. For with such publicity, and such a method of appraisal, insuring a proper valuation of all property used as security against which bank credit could be issued, the

public would have full confidence in the resulting medium of exchange.

So much then for one step, the safe public appraisement of property for bank loans. Now let us proceed to the next step, the determining of the percentage of loan to value, that is the amount which could be loaned on any particular kind or piece of property.

Just as the placing of the actual appraising of property in public hands would give public confidence to the resulting valuation, so would placing the authority to say on what terms a bank may make a loan and how much it may lend on any property. This fixing of the percentage of the loan is a simple matter and requires neither technical knowledge nor special information.

The relative safety of various securities is quite well established. The less the fluctuation in the price of a security, the safer it is as a basis for a loan, and consequently, the higher should be the percentage of the loan to the actual appraised value.

Thus good bonds, and business property in well established communities come under the heading of gilt edged security, and command the highest percentage. From this mark, which may run as high as eighty or even ninety, the percentage will shade down to twenty or even ten per cent on a hazardous security.

Here again the proposed plan would involve no great change in present-day methods, except to the extent of taking the determining of this percentage out of the private hands of the banker, and placing it in public hands. By so doing we would do away with favoritism and at the same time insure the safety of the loan and,

consequently gain public confidence in the resulting medium, the bank credit that is created by the loan.

What is required in this phase of the matter of creating bank credit, then, is a proper authority in whose hands may be placed the function of establishing a table of percentages of loan, to value for various kinds of property.

This duty would not call for expert knowledge. The present banking practice, which is the result of experience, would be a sufficient and a safe guide for the authority to whom this duty might be intrusted. And the advantage of such a method would rest not only in its simplicity but in the fact that, since the resulting percentages would be determined publicly and would have to be published, everyone would become familiar with them.

If they should be placed too high the banks would not make the loans and if they were too low those affected would agitate until they were raised. These percentages would have to be fixed at a point where both bankers and the public would agree that they were safe and just. The public would then have full confidence in the bank credit issued for all would know there was ample security behind every bank loan.

And once more we find that we have a system of machinery for this operation also, that is already at hand, and which, with a few changes, can be admirably adapted to the new purpose.

The banking laws of the nation and of the various states now provide a public authority whose duty it is to supervise the banks established under those laws. In the hands of this authority, whether a Federal Reserve

Board, or a State Superintendent of Banks, we find the proper place to entrust the power and duty now under consideration.

The plan needs little explanation. It consists mainly in giving to the public authority the right to regulate bank loans which would include the power to determine the percentage the loan may bear to the valuation set on the security; these percentages would be set by means of rules, which, of course, must be general in application and should be published before becoming operative.

The rules to be made by the public board would be suggested by the present banking system and should follow the best banking practice, and be changed only as experience dictates.

Special interests could not be favored, for all rules would have to be general and would have to be published.

We have now dealt with two of the three phases of extending loans and so creating bank credit, the medium of exchange. We have seen that the solution in each case involves the placing of the fixing of value, and of the loanable percentage of all property in public hands in such a way as to insure both just methods and public confidence.

Now let us look into the third phase, that of granting or refusing a loan.

The authority, to say yes or no to a would-be borrower, now rests entirely with the bank. And so long as it is left entirely to the judgment of private persons it will be tinged with favoritism.

If a man complies with the rules for the use of any other public utility, he is entitled to impartial treat-

ment. If he buys a railway ticket he has the right to ride regardless of whether the conductor favors or dislikes him.

To accomplish justice, so that all may use this, the greatest of all our public utilities, upon fair and equal terms, the final power of granting or denying the use of the medium should then also be enforced by public authority and applied impartially to all applicants.

The question is likely to arise—Do not the banks compete with each other in getting business, and is not lending money the most important source of bank revenues; therefore, do not bankers exercise the greatest liberality in their dealings with borrowers, unless perhaps in a remote community controlled by a narrow-minded banker?

The answer to this question is in the negative. The objection will seem valid only to the uninitiated person who has never done business with banks. For the truth is that banks do not compete in making loans. Take the case of a business man, for instance, who has a going business and desires a loan. He approaches the First National Bank say with which he has an account. The bank officials may have been offended by his political activities or business methods, or his interests may run counter to those of some of the bank directors. So he is informed that the bank is not prepared to extend its loans.

Knowing that he is deserving of credit, the business man then goes to the Merchant's National Bank and applies for a loan. He is asked by officials there who his bankers are. When the answer is made that he has

been doing business with the First National, the reply to his application for a loan will probably be the stereotyped one: "We would appreciate your business, but it is against our policy to open an account with a loan."

The foregoing is but a single instance of the discrimination which prevails in the matter of extending or refusing bank loans, and so of permitting or denying the use of the medium of exchange, under our present system of unrestricted private control. The removal of this discrimination is possible only by placing the use of the medium of exchange under public control.

However, public control of bank loans should not be effected in any such manner as to hurt the banks, or to take just profits or powers away from the banker. Any reform should be dictated solely by the desire to make the bank more serviceable to the community.

The only object of any suggested change should be to secure the fair and equal use of the medium of exchange, upon safe and equal terms, by all members of the community who can comply with the conditions and pay for the privilege of using it. While divesting the banker of all power to show favoritism he must be left free to protect himself against loss and should, therefore, be assisted in making all loans safe. He should be encouraged to refuse a loan so long as there is any doubt as to its safety, but he must not be permitted to refuse one on any other grounds.

Bankers are inclined to lay stress on the "moral hazard" of a loan which suggests that some men are more reliable than others. The fact that there is a difference in reliability among men may be admitted

but that the banker has any means of knowing which are and which are not reliable is not admitted.

His surmise in this direction is due altogether too much to favoritism or personal interest. And even if the banker were infallible and did know who are and who are not reliable all loans must not only be safe beyond question, but the people must know they are safe. There is therefore, but one basis, safe security.

The safety of our medium of exchange is a matter of such importance to all that we cannot let it rest even in a slight degree on the guess of anyone as to the reliability of a borrower. "Moral hazard," while not denied, must be disregarded.

The present practice of banks lending without security to those well and favorably known to them could probably be continued under proper restrictions provided the bank does not lend in this way more than the bank's paid up capital and surplus.

The capital and surplus of the bank may be considered as private property and subject to private control the same as other private funds. If the stockholders see fit to give the bank management the right to exercise their judgment as to "moral hazard" up to the amount of the capital and surplus that may be considered a private matter.

But when the bank goes beyond its capital and surplus in making loans it becomes a public matter, for the bank is then trading solely on public laws and public confidence. It is performing a public function, that of issuing our medium of exchange, and favoritism must be eliminated.

For its own protection, and in order to insure safety to our medium of exchange, every bank must be allowed to refuse loans under certain conditions. But in order to guard against unreasonable refusals, resulting only from personal prejudice, partiality or personal interest, the banks should be required to give with all refusals a written statement of their reasons for such refusal. The borrower should then be given a chance to remove the objections or to protest this refusal before the public bank supervising authority, and if it should appear that the loan was refused for any other reason than to guard against a bad loan the bank should be severely penalized.

If found necessary to insure fairness to all, the borrower might be given the right to go direct to the Federal Reserve Bank when refused by private banks.

Here, then, we have all three phases of making a loan covered by adequate remedies.

In effect, the remedy, as we have suggested it, would be to take out of private hands and place under public control the right; first, to determine the value of the property offered as security for the loan; second, the right to determine the percentage of the loan to the value of the security; and third, the right to refuse or grant the loan, so that all may have the use of the medium of exchange on exactly the same terms.

In the foregoing pages it has been clearly established that bank loans are not a personal matter between the banker and the borrower because they effect the welfare of the whole community.

It, therefore, follows that their use is a public right

and all must be entitled to enjoy that right upon fair and equal terms, and no one should be given an unfair preference, or receive any unjust advantage.

Let us see how this plan would fulfill the two requirements we have seen to be essential to an adequate system of exchange; first, stability through proper elasticity, and second, acceptability through public confidence.

In the first place, the medium of exchange, would, under the proposed plan, vary according to the needs of business. For, since the determination of the volume of the medium of exchange would no longer be in the hands of private persons, the restriction on that medium, which we have seen inevitably accompanies private control would no longer exist. The use of the medium of exchange would be a RIGHT and not a PRIVILEGE as it is now. Every one who could comply with the requirements would have equal opportunity to use the bank when and as desired. In other words, contraction, through private control, would not occur.

And on the other hand, inflation would not exist either. For the plan would involve the necessity of having adequate security behind each loan, and, therefore, bank loans would not be extended beyond the needs of business. No one would borrow unless he expected to profit by so doing.

And, as we have seen, public confidence in bank credit would exist to one hundred per cent. Public appraisal of the value of security and the fixing of the percentage of the loan would result in certainty that there was full value behind every loan extended.

There would then be no necessity for gold reserves or any other reserve to bolster confidence in the banks. The fallacy of the gold reserve and the fiction that bank credit calls for money could be discarded. Public confidence in the banks would be gained and held by the fact that every bank loan was amply secured and, consequently, every bank deposit was perfectly safe.

The only reform suggested here comes to the simple proposition of changing the basis of our medium of exchange so that it will rest on the truth and good security, instead of on a false promise of gold redemption and a fictitious reserve.

The point cannot be too strongly emphasized that there is no change suggested in the whole system except a change of base, from one of fallacy and fiction to one of truth and honesty. The few details necessary to make the suggested change are simple and practical, and are now well understood. That the remedy would prove a complete cure for our present ills, is evident, for it completely overcomes the defects in the present system. The proposed method of dealing with bank loans would put 100% safety and 100% elasticity into our medium of exchange.

A further advantage is that the changes necessary to accomplish this end are but slight. They involve, as we have seen, but a few changes in present laws to alter existing institutions to a slight extent.

With laws in effect to accomplish the foregoing plan, the method of obtaining a loan from a bank would be practically the same as now. The rules laid down by the public authority would in all probability preserve

the present banking practice regarding loans on business statements and personal property in toto. About the only change in the making of such loans would be that all applicants would receive the same treatment.

Most business would be conducted, just as at present, but with much greater certainty and satisfaction to both borrower and banker. Business men could at all times know just what amount of credit they were entitled to use and bankers would know that every loan they made was safe. Such a system would do away with the greatest source of business worry for all.

Through the suggested method, the procuring of real estate loans would be greatly simplified as well as hastened and cheapened. The borrower would get from the office of the Assessor a certificate setting forth the assessed value of the property which he proposed to use as security. This "certificate of assessment" would set forth the ownership, the location, the amount and the value of the property.

By multiplying the value of the property as set forth in this certificate of assessment, by the percentage as given in the official table of loan value, the loanable value of any security would be obtained and every person would know what amount could be borrowed from a bank at any time.

For instance, suppose the security to be offered were a farm of one hundred acres. The owner would get from the Assessor's office his assessment certificate which would show his farm was assessed at say $150 per acre. Let us say the percentage established for such property were 60%. The appraised value of the farm would then

be 100x150 or $15,000 and the loan obtainable on it would be 60% of $15,000 or $9,000.

Or say the security were six automobiles priced at $2,000 each. Then the six would be worth 6x2000 or $12,000. Now, suppose that such security were listed as being good security for 50% of its value. Then the owner of the machines would be entitled to borrow from the bank 50% of $12,000 or $6,000 on a bill of lading or a proper warehouse receipt.

In either case, when the borrower presented his notes and security to the bank in proper form, the loan would be made. If it were not made, the banker would have to state in writing why he refused to grant it. No trivial reason would be acceptable, and if a good reason existed, it would be against public policy for the loan to be made until the objection were removed.

The rules laid down would of course provide for the discounting of acceptances, etc., and of automobile and other paper on whatever terms have been found safe, so that the various selling plans, which have been built up, could be used without interruption.

There is no suggestion of any new way of making loans or the use of any business forms or methods not now in vogue.

No bank should be compelled to make a loan unless the security were proven good and on the other hand any bank which persistently refused to make a loan because of personal feeling should have its charter annulled. Good security for every loan and no favorites, should be an invariable rule.

The object of public control of the medium of ex-

change would always be to facilitate and not to hamper business. Experience would probably develop many improvements on present methods but we must not lose sight of the fact that the first requisite of a medium of exchange is acceptability and that depends on its safety.

This statement, however, does not mean that better methods than those in use may not be developed.

For instance, it would not be out of place to make mercantile agencies such as Dun and Bradstreet public institutions. By so doing their records would be more valuable to the business world. By extending these records to take in the work of merchants associations, those who do not pay their bills as well as those who deal dishonestly could be eliminated from the community.

If paying one's debts and honest dealing were necessary as a qualification for the use of credit it would put a very high premium on honesty. At least the community could be put on its guard against those who did not pay their debts or deal fairly.

This idea is not suggested as being at all necessary to this plan for putting bank credit under public control but is merely offered as an improvement on present conditions which might be considered later.

By making all bank loans conform to the rules laid down by a public authority, and by basing them on security which the people themselves have appraised, every bank depositor would know that every loan made by every bank was good. By this means we would secure to our medium of exchange the maximum of safety and also the maximum of elasticity.

Thus a medium of exchange would result that would

fulfill all the functions required of it. No longer would it be a hindrance to commerce and industry, but rather the help it should be.

Production and trade would be allowed to expand to their fullest extent, for they would control the medium of exchange instead of that utility controlling them, and the results would be beneficial to all.

Private control, which now has an automatic tendency to cause our medium of exchange to contract and strangle business as soon as prosperity makes a demand for credit, would be gone. Prices would remain stable except when affected by the laws of supply and demand.

Business would no longer be a gamble and success would depend on efficiency and hustle and not on chance or a pull with the banker.

A period of prosperity would not be followed by one of depression; all branches of industry could be financed; foreign trade could be carried to any degree of safety; our shipping business would be rehabilitated and reconstruction would bring peace and prosperity to a troubled world. All the changes made would help not alone this country but all humanity.

And the advantage accruing from the fact that the changes required are but slight cannot be over-emphasized. The real change would be in the improved conditions which would follow as a result of the change and which would be to the benefit of all concerned, except perhaps to a few who are today holding an unfair advantage over their fellow-men.

The laws necessary in order to bring about the desired change are given at length in the next chapter. These

laws are presented in legal form in order to show how easily the reform may be put into effect, and in order to point out definitely the way in which all the desired advantages can be secured, so that our social system will be freed from many of the evils that hamper and oppress it today.

CHAPTER VIII

BREAKING THE STRANGLE HOLD

WE HAVE now pursued our problem in logical order. Taking up the known defects of our financial system, as related to our industrial and social life, we have shown that the same defect which has always excluded the farmer and has recently excluded the exporter from the use of the bank has shut the bank doors on the automobile dealer and may shut it on other industries at any time.

It has been shown that because of the false foundation of our system of credit—the gold standard—our present day industry has outgrown the system.

The gold redemption promise has outlived its usefulness and has become an automatic check on the wheels of industry.

To continue to confine our credit system by a false promise to redeem in gold would be like trying to carry on the industry of the country while confining our transportation system to a narrow gauge railroad. And then, if private ownership of banks is going to be allowed to deny the use of one public utility, why not permit those who own the railroads the same privilege?

Such an arrangement could not help but check progress and cause industrial turmoil and social unrest.

Our present depressed condition is brought about through industrial progress being checked for want of proper credit facilities.

We have already noted that the high cost of living has recently been considered to be the cause of bad economic conditions while the social unrest of a generation ago was believed to be caused by the low cost of living. We have seen that these conditions refer to the general price level and are due to increase or decrease of the volume of the medium of exchange in use. We have noted from our own experience or observation that high prices stimulate production and trade while low prices produce an opposite effect, but we have also noted, that a period of high prices, good business and prosperity is invariably followed by one of falling prices, business failures and economic depression. The cause of this phenomena has been definitely pointed out and has been shown to be due to defects in our present banking system arising from its private control.

Most countries have passed through a period of development where the mint was in private hands. Only in primitive times was this important function so administered and while it was in private hands it was subject to all the abuses of private control of a public utility.

As a nation, we outgrew this national weakness, while quite young so its bad effects are not remembered, but Mexico, during the long period of internal disturbances and bad government preceding the period of Porfirio Diaz, adopted the disastrous plan of leasing her mints to private citizens.

Freeing his country from the tentacles of the mint lessees and restoring coinage to government control was one of the greatest reforms carried out by Diaz, reactionary as he was in many respects.

Here we see the evils of private manufacture of metal coins. But metal coins are, in our modern system, but a minute part of the entire circulating medium, which is almost entirely composed of the credit manufactured by banks.

Just as industrial and social advancement forced the mint out of private into public hands so must industrial progress and general enlightenment break the strangle-hold of private interests on our individual and national life by substituting public for private control of bank credit.

The blighting effect of private control of this greatest of public utilities, on both private and public interests has been demonstrated many times and must not be lost sight of.

The importance of the medium of exchange cannot be over estimated. We have seen that, through it, by the contraction or inflation of its volume, prices fluctuate and with them fluctuates the value of our pay check, our property and our fortunes. As prices fluctuate so fluctuates our standard of living, our comforts, our happiness and our whole aspect of life. Nothing then can be of more importance to us as individuals and as citizens than this matter of the medium of exchange.

It is because of the importance of the money function that coinage has always been considered a government duty and privilege. No privately issued medium could gain and hold public confidence. Without confidence the medium would not be accepted so it failed in efficiency as an exchange medium in the same proportion as it lost public confidence.

History taught the business world that the medium of exchange must not only hold public confidence but it also taught that a mixed coinage within the same country checks material progress just as effectually as the confusion of tongues checked the building of the Tower of Babel.

A uniform medium is necessary for commercial development and, therefore, it should have but one source of issue and that should be through the government. Because of this knowledge, gained through human experience, the Constitution of the United States reserved to the Federal government the right to coin money. At the same time it jealously guarded this right when it denied that privilege to the several States.

Section 8, Article 1, of the Constitution says: "The Congress shall have power . . . to coin money and regulate the value thereof" and Section 10 of the same article provides that, "No State shall . . . coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts." There is no other reference to money or to the medium of exchange in the Constitution.

That, by the foregoing, the framers of the Constitution intended to reserve to the Federal government the sole right of money issue seems quite plain and the general opinion is that our government really does issue the medium of exchange.

We, however, have seen clearly that this is not the case. We have seen that while the banks do not "coin money" they do issue and control our medium of exchange which is the very function the Constitution by the

foregoing provision intends to reserve to the National government.

The proviso that no state shall coin money or issue bills of credit makes it quite plain that the framers of the basic law intended to reserve the money function to the Federal government. Otherwise the proviso would reserve only the right to coin the change while the banks issue our money.

If private institutions are permitted to issue their credit to be used as a medium of exchange why should not the state or the counties or for that matter, the various cities have the same privilege?

How can government officials justify the present practice of permitting private institutions to issue credit to be used instead of money in the face of this prohibition against permitting the states to coin money or to issue bills of credit?

The state's credit is certainly superior to that of any bank, because the state possesses the right to tax the bank as well as other property within its boundaries and a state's promise to pay is a mortgage on all the property within its confines, including that of the bank. If no state may coin money or "emit bills of credit," certainly no corporation, the existence of which depends upon state law, should be permitted to exercise this function either directly or indirectly.

It is equally certain that a national bank, being a private institution, has no better constitutional standing than the state bank as a source of money issue. The fact that it is incorporated under a national law or that the medium of exchange it issues is called "Credit" instead

of money, or coin, or currency, gives it no right to usurp an exclusive government function.

Consequently, it is plain that it was never contemplated by the framers of the Constitution, nor is it now intended, that the circulating medium of this country should have any source of issue other than that of the Federal government. Regardless of these facts and of these provisions we find that because of the constant increase of the banking habit, all of our medium of exchange today, except the small change, is issued by private institutions.

In plain but unmistakable language the constitution reserves to the Federal Government alone the right to issue money and prohibits the states from so doing but, notwithstanding this direct reservation and prohibition, state banks as well as national banks are substituting their credit to be used as money.

It has already been shown that this is issued by the bankers entirely at their will. In other words, commercial development has substituted the credit of private institutions for a medium of exchange controlled by the government and by reason of this substitution the banks have usurped the most important government function. It is impossible to reconcile this state of affairs with the provisions of our Federal Constitution or with common sense. Our present practice then is without doubt in violation of the basic law of the land.

Notwithstanding these constitutional provisions it will be shown in a later chapter, devoted to the Federal Reserve System, how Congress, through the Federal Reserve Act, even went so far as to put the credit of

the United States behind the personal judgment and private interests of the bankers with the avowed purpose of turning their credit into government currency, thus aiding and abetting this illegal practice.

Other attempts to use a privately issued medium of exchange have been suppressed by the government. In those instances the substitutes for money which were used had no camouflage to conceal their true nature, so they were plainly violations of the constitution and our coinage laws. But the fiction by which the banker credits the borrower with a deposit has concealed the true nature of bank credit and permitted it not only to nullify this provision of our fundamental and statute law but even to command the aid of Congress in so doing.

No one can be blamed for this state of affairs for it comes about because of the general misconception concerning our money.

All public officials, however, are sworn to uphold the constitution and laws so when this violation is clearly shown, as it has been, it now becomes their sworn duty to see that the violation of the Constitution is stopped.

It has already been shown that it will not be a difficult task to recover the money function to the government. No court proceedings will be necessary. The remedy is constructive not destructive.

By a few slight changes in existing laws we can comply with the Constitution and restore the money issuing power to the people.

We have seen how this result can be accomplished by a few simple changes without upsetting the present

system of banking or changing our manner of doing business, and without any risk of political inefficiency or of personal loss.

A few words written into the Federal Reserve Act would give the Federal Reserve Board power to define the securities on which and the manner in which banks may make loans. Since the Federal Reserve Board is a government institution, like the United States Mint, our medium of exchange would then be issued under Federal authority and the constitutional provision for Federal control of our money or medium of exchange would be satisfied.

With the Constitution thus enforced, all institutions that accept deposits and grant credit including state banks and trust companies, should be compelled to become members of the Federal Reserve system.

The rules laid down by this public authority would then unify our medium of exchange and give public control to our greatest public utility.

Besides such adjustments as would take from the banker the arbitrary power to refuse loans for purely personal reasons, we should do away with unnecessary reserve restrictions and the regulations that prohibit national banks from making loans on land.

With the suggested change in the Federal Reserve Act accomplished, the states in self defence would be compelled to make modifications in their appraisement machinery, so as to adjust the assessor's office to the fixing of values of property on which loans might be sought from the banks. Not a difficult task as has been shown and will be shown more definitely later on.

The reform should be national because the Federal government should control the money function. However, it is not necessary to await congressional action. It may be accomplished through the state banking system, and, by bringing pressure on the Federal govern-through the states, national action will follow.

Every state has its banking department under one or more state officials. We here suggest a model law by which any state may take control of the issuance of bank credit under the state banking system.

The state banks would still violate the spirit of the constitution, but not in as great a degree as the present practice.

To secure public control of the state banking system we suggest as an amendment, which will fit into the code of practically any state, the following:

> The State Banking Department shall, and there is hereby vested in it, the power to make and publish such rules and regulations and define such terms as in its judgment may seem wise and expedient for the government of all banking corporations, which rules and regulations shall be general and shall not conflict with any of the laws of this state or of the United States; but which SHALL DEFINE THE SECURITY ON WHICH, AND THE MANNER IN WHICH, SUCH CORPORATIONS MAY MAKE LOANS AND INVESTMENTS OR BECOME LIABLE ON ACCEPTANCES OR OTHER EVIDENCE OF DEBT: provided, however, that no such corporation shall be compelled to make any loan or investment, nor become liable on any obligation or other

undertaking against its will; nor shall any such corporation have any claim against the state banking department or a member thereof or against the State for any loss which it may sustain because of any of the rules and regulations so made and published. It shall be the duty of said department at each regular meeting and at any special meeting called for that purpose to examine all reports made by said corporations relating to their condition, and all reports of regular and special examinations made by the state examiner and deputy examiners and filed with said department during the preceding quarter or such period as shall have elapsed since the last meeting of said department and to approve or disapprove the same, and to make and enforce such orders as, in its judgment may be necessary or proper to protect the public and particularly the depositors or creditors of said institutions. Said department and the state examiner and deputy examiners shall have the power to subpoena witnesses, administer oaths, and generally to do and perform any and all acts and things necessary to the complete performance of the duties herein imposed, and to enforce all of the provisions of this act and for the purpose of enabling them to perform all the duties imposed upon them, the provisions for such purposes shall be held as applicable to their proceedings. Any and all orders made by said department shall be immediately operative and may be enforced by a court of competent jurisdiction. Said department shall keep a full and complete record of all its proceedings and of all orders made by it, and the records of the

state banking department of the state examiners and of any and all reports made by or filed with the department or the state examiner, shall, under proper restrictions, during regular business hours, be open to inspection and examination.

The object sought by such a law is to standardize the security on which banks may make loans, so as to prevent discrimination and also to assure the public that all bank loans are made on safe security in order to put full public confidence behind the banks and keep it there.

The essence of the whole matter is but a slight change in the present practice and is contained in the first few lines, which give the state, through public officials, power to make rules defining the SECURITY ON WHICH AND THE MANNER IN WHICH BANKS MAY MAKE LOANS.

The only way in which it would be possible for the state banking department to profit by the power here granted would be by making rules that would be satisfactory to both the banks and the people. All rules must be general and then must be published, so no personal interest in the public control could possibly be served. The powers granted the state authorities are broad enough to permit them to annul the charter of a bank that would persist in refusing loans on personal grounds.

Through public control all arbitrary power would be wiped out and each element in the community, by looking after its own interest, would check up and balance the whole system.

Should the public authority which makes these rules,

deem it advisable, banks might be left free to loan the amount of their unimpaired capital without restriction.

As a means of explaining favoritism to certain borrowers bankers have put forth the idea that personality enters largely into the making of loans. Some men, they say, are worthy of a loan without security. This no doubt is true, and since the capital of the bank may be looked on as private property, the public authority making the rules might, if it thought best, allow the banker to exercise his judgment or we should better say show his favoritism to the extent of the bank's capital but not beyond that.

As soon as the banker in making loans goes beyond the bank's capital and surplus he is trading on public confidence and that belongs to the people, so it must be treated as public property.

The values of stocks and bonds are fixed daily by the dealings on the stock exchange and of practically all commodities by transactions in the various marts of trade such as the wheat pit, cotton exchange, etc.

While real estate values are to a degree fixed by net income and occasional sales we must have a sure method of fixing such values.

As explained in the last chapter this object would be accomplished by making the assessed value, that is the value placed on the property by the assessor for tax purposes, also the appraised value which the banks must accept as the security value.

The following laws are for the purpose of arriving at the true value of all assessable property. By the operation of these suggested laws we would not only arrive

at a safe basis of security for bank loans, but we would put our assessments for taxation on a just and fair basis.

The two following suggested laws explain themselves:

AN ACT

To provide for the hearing of grievances caused by assessments for taxation and for appeals from the decision of boards of equalization and review.

BE IT ENACTED by the Legislative Assembly of the State, etc., or whatever the enacting clause may be:

SECTION 1. Any person being aggrieved by the return of any assessor of this State may submit such grievance in writing to the clerk of the proper board for the equalization and review of such assessment not later than five days after the regular first meeting day of such board; no such statement of grievance shall be ignored by said board for lack of form, nor for any other reason, provided, it is signed by the party aggrieved or by some other person in his behalf, but all such complaints shall be taken up and decided by the board without delay; should the complainant or any other person be aggrieved by the decision of any board of equalization or review an appeal may be taken by such party by filing a notice of appeal with the clerk of said board and the payment to the clerk of the required fee within three days after the rendition of such decision; when an appeal is taken under this section it shall be the duty of said board to submit all questions in dispute to a jury of arbitration as in such cases provided.

SECTION 2. For the purpose of enabling all boards

of equalization and review and the clerks of said boards to perform all the duties imposed upon them they shall have, and the power is hereby given them, to subpoena witnesses, call jurors, administer oaths and to do and perform any and all acts and things necessary to the complete performance of such duties.

To provide for a jury of arbitration and to regulate appeals from the decision of boards of equalization and review the following is suggested.

AN ACT

To provide for juries of arbitration in assessment cases.

Enacting clause according to the state:

SECTION 1. All juries of arbitration in cases where an appeal is taken from the decision of any board of equalization and review shall be composed, drawn and summoned in the same manner as juries in civil actions in justices' courts, except that the clerk of the board shall act instead of the justice, and for this purpose, and to the extent necessary, said clerk is hereby given all the power and authority of a justice of the peace; provided, however, that for juries of arbitration only those persons shall be listed or called as jurors who may reasonably be supposed to possess accurate knowledge of the value of the kind of property in question, or who are the owners of the same kind or similar property in the neighborhood of the property under discussion.

SECTION 2. Fees in all cases for service on a jury

of arbitration shall be the same as in civil cases in a justice's court and must be deposited with the clerk before the jury is summoned.

SECTION 3. No person shall act on more than one jury of arbitration during any one year, but there shall be no other grounds for challenge, except lack of knowledge of the value of the property, lack of ownership of similar property, bias or undue interest in the outcome of the arbitration.

SECTION 4. As soon as the required number of jurors are selected the clerk shall administer the following oath: You and each of you do solemnly swear that you will render a verdict according to your best knowledge and belief.

SECTION 5. After the jurors are sworn they must sit together and hear the allegations, evidence and argument, which must be delivered in public, in the presence of the clerk or his deputy who shall conduct the proceeding as nearly as may be in accordance with the practice of the District court, except that the jury shall be given until two-thirty P. M. of the day following the close of the hearing in which to render a verdict and the jurors shall not be required to stay together nor to refrain from talking about the matter in hand.

SECTION 6. Two-thirds of the jury must agree in order to render a verdict which must be in writing and signed by each juror agreeing thereto and when so signed the verdict must be accepted by the clerk and the jury discharged; provided the said verdict definitely settles the question or questions submitted,

and as regards these questions, the verdict so rendered shall be final, and shall be preserved and treated as part of the proceedings of the board of equalization and review.

SECTION 7. Any juror not agreeing to the verdict may have his objections thereto recorded with the verdict, and any juror not signing the verdict or recording his signed objections thereto shall receive no fees or other compensation.

SECTION 8. Any jury failing to render a verdict within the time specified in this Act shall be discharged and no fees shall be paid to any of the members thereof; whereupon the clerk shall proceed to draw another jury without delay and the same procedure shall be had until a verdict is rendered.

SECTION 9. No verdict nor the objections thereto nor any record of the proceedings had shall be added to, subtracted from or in any way changed after the jury has been discharged.

Besides the foregoing laws there should be introduced into the law prescribing the duties of Assessors a provision that, on application of or on an order from the owner of any property on the assessment roll, the assessor shall furnish a "certificate of assessment" in the form prescribed by the State or National Banking Department. A fee may or may not be charged for this service.

While no law which will fit into the code of all of the States can be laid down in exact terms, the foregoing suggestions carry all the principles which are

necessary to put state bank credit under public control, and the method of carrying them into effect has been fully explained in the last chapter.

As previously stated, the national banks can be brought under public control by giving to the Federal Reserve Board the same power over member banks as is given over state banks by the first act presented here.

This can be accomplished by amending the Federal Reserve Act as follows:

To Section 11 of that Act, after the words, "The Federal Reserve Board shall be authorized and empowered:" add these words:

TO DEFINE THE SECURITY ON WHICH, AND TO PRESCRIBE THE MANNER IN WHICH, MEMBER BANKS MAY MAKE LOANS AND INVESTMENTS OR BECOME LIABLE ON ACCEPTANCIES OR OTHER EVIDENCES OF DEBT.

To fully satisfy the constitutional provision for Federal control of the medium of exchange all banks should be compelled to join the Federal Reserve system. With these two suggestions put into effect each state should pass the suggested laws providing for appeals from boards of equalization and for a jury of arbitration. Practically nothing more is necessary in order to put the control of the money function into public hands.

As the rules governing bank loans would have to be published and would apply to all alike, our whole financitl system would then be unified. Applications for loans would be treated on their intrinsic merits without injustice or favoritism.

This object can be accomplished without the least upset to business and the improvement in our industrial, social and political life which would follow the change can hardly be estimated.

By means of a few words placed in the Federal Reserve Act the basic flaw would be removed from our social system; our constitutional rights would be regained and the last vestige of privilege would be destroyed.

We have seen how the use of a commodity, as the medium for carrying on exchange, subjects all trade and through it the productive energy of the community to the will of those who are able to control or corner that commodity.

The use of one commodity as a medium of exchange is the basic flaw in our civilization which has hampered progress and stood in the way of the peace and happiness of mankind from the very beginning of civilization.

It has been shown that when the commodity itself was no longer used as a medium of exchange the same condition was continued by a promise to pay that commodity.

When gold could no longer fulfill requirements as a medium for carrying on trade there grew up a custom of using for that purpose a promise to pay gold. And, although this promise has been proved false by panics and the many subterfuges used to escape its fulfillment, we still cling to it without justification or reason as a baby clings to a rattle.

Through the use of a commodity as a medium and by confining credit to a promise to pay that certain commodity the present financial system gives into the hands

of those who control that commodity a power over the daily life of the members of the community such as no political ruler ever possessed.

This glaring defect in the very foundation of the industrial system which supports civilization seems to have been overlooked and man in his quest for liberty and equality has always directed his efforts against political instead of financial rulers. These misdirected reforms could not reach the goal of personal liberty and equality for they were not aimed at the power that dictates personal welfare.

Mankind has been cheated out of those rights which our Declaration of Independence says are inherent and unalienable by the financial system and not by political government.

As long as the money function is performed by a certain commodity or the promise to pay that commodity or as long as the control of credit remains in private hands, the success, prosperity and happiness of the members of the community will be at the mercy of the few who control that commodity or the credit resting on it.

This condition has been felt but not logically and clearly noted, and resentment, though not clearly defined, has given rise to such terms as Financial Oligarchy, Moneyed Aristocracy, Plutocrats, etc.

These epithets have been hurled at the heads of practically all men who have been financially successful; they are favorite terms with certain would-be reformers and the purpose of their use is to excite class hatred.

It is not the part of intelligence to blame individuals for the faults of a system.

If a flaw in our economic system makes it possible for the minority to gratify a natural desire for power at the expense of the majority the attack should be on the system and not on the men who take advantage of it.

A slight change in existing laws will cure this defect. The improvement in national efficiency and personal well-being which would follow the change would be immediate and most gratifying.

There would be a decided gain in business freedom and productive energy, because the medium for conducting business and carrying on industry would be open to the use of all. Banks could then grant the long time credits necessary to revive our foreign trade.

In our present system the use of this medium is restricted both by the private interests in control and by the limitations of the gold reserve requirements.

We might in a measure foresee this improvement by noting the change which was brought about by placing the railroads under public control through the interstate commerce law. This comparison, however, is not a fair one for several reasons.

For instance the medium of exchange is a much more important public utility than the railroads and enters more intimately into the life and activity of every individual in the community. Every member of the community must use the medium of exchange and all are directly affected by its fluctuation in value.

For these reasons then, the abuses due to its private control have a much greater effect and are far more harmful though not so easily seen as these incident to railroad control. Finance is at the base of practically

every activity of life. No productive enterprise can start or continue without the use of the exchange medium.

It has been shown here in detail how the fault in our system can be removed. To follow out and show the changes which would come about through this improvement in our system is unnecessary.

It is enough to know that all these changes would be for the better. This must follow as a natural result for the suggested change puts into effect the principles on which our government is founded.

Liberty and equality are the inherent rights of all citizens and neither can exist in a state where any man or set of men controls that which others must use.

Bankers, as a class, are prone to criticise union labor and the "closed shop" as being opposed to industrial progress and American principles. But, may we ask, if the "closed shop" is harmful and un-American, how about the "closed bank"?

It is quite evident that so long as any set of men possess the right to deny to other men the use of that which they must use in order to make a living or attain success and happiness neither liberty nor equality can possibly exist.

A system which practically compels the banker to refuse the use of the medium of exchange to a farmer who by every right is entitled to use it and then permits that banker to grant its use to the speculator for the purpose of purchasing and holding, for profit, the farmer's crop, is contrary to every American principle and to the best interests of every citizen.

That our present system is inefficient, unjust and un-American, cannot be denied.

Almost every economic factor, except the one which is the real cause, has been blamed for our present ills such as trusts, the stock exchange, wheat pit, profiteering, labor unions, politics, etc. But we will see that the fault in these factors is really due to the bad effects of a defective system of exchange.

It will be shown in later chapters that the so called "Trusts," for instance, are not the villains we have thought them, but, that practically all the villainy is the work of one trust—the "Money Trust"—which has finally been located and which will be put out of business when the remedy here suggested is put into effect.

Industrial turmoil and social unrest are the result of the money power holding control over productive enterprise. Apply the "open shop" principle to the bank. Open the bank door to all industry and keep it open. Stabilize the value of the dollar, and the chasm between capital and labor will be bridged.

In preceding chapters we have definitely located the two glaring defects in our financial system—private control and a false basis for credit. We have also discussed in sufficient detail a remedy which is practical, and right in line with American ideas and which completely eradicates these defects without disturbing business or injuring any one. When this simple remedy is applied prosperity will be restored in greater measure than was ever before enjoyed and our national efficiency will be greatly increased as will be shown in a later chapter.

The various attempts which have been made to counteract the bad effects of these two weak points in our system, especially the Federal Reserve Act and the Farm Loan Act, can now be reviewed in a different light than has heretofore been applied to them.

The chapter on the Federal Reserve System will warrant special attention for the functions of that institution are at present not well understood. It will be shown that in its present form it is a decidedly un-American institution.

Some of the mysteries of the New York stock exchange will be cleared up in the chapter on "Speculation" and "Foreign Exchange" will be explained in a chapter under that title. It will be shown that the faults existing in these various economic factors will disappear when the remedy offered is applied.

Since the need for reform must be clearly established before asking that present conditions be changed the chapters immediately following are designed to show that need.

The chapter on "Modern Feudalism" shows how un-American our present system is, the one on "Interest" shows how unjust and oppressive it has been and can be and the "Gold Standard" chapter, by using the words of an ex-Secretary of the Treasury shows how extremely false it is. AMERICA stands for just the opposite of all these and the suggestion here is to Americanize America by making our financial system conform to American ideals.

CHAPTER IX

MODERN FEUDALISM

EVERYBODY is more or less familiar with the historical epoch known as the Feudal Era. Every school history contains a discussion of it. And so everybody will perhaps remember how, in the ancient feudal states, the king was supposed to own all the land; how he distributed this land among his vassals, lords and dukes, and how they in turn divided the land allotted to them among their own vassals, the barons and knights; and how each in turn acknowledged the authority of his immediate master, and rendered services to him.

Below these various layers of vassalage and subvassalage were the common people, who tilled the soil, and supported the privileged classes, enabling the latter to spend their time in feasting, fighting and enjoying life generally.

Such a system was one of a bye-gone era, and one that has long passed out of existence; today we are supposedly living in an era of individual liberty and equality.

And yet, when one looks below the surface, it will be seen—and those who have read this far already see—that this freedom is more apparent than real. For there exists in our financial system, the most important institution of today, a system of feudalism which, while less obvious, is thereby the more far-reaching.

With regard to the ownership of land, and the control of it, the system of feudalism has long passed out of existence, but it finds a perfect counterpart in our present banking system.

The head of the feudal financial state resides in New York, with headquarters in Wall Street; the dukedoms are presided over by the banks of the reserve cities; the barons and knights who rule the lesser cities and towns are tributary to these financial powers; and just as in the old feudal system, the people though no longer called serfs, are the subjects of this money power.

It is true that the old system has been refined somewhat. The autocrat no longer has the power to chop off the physical head of an inferior. Instead he has the right only to cut off his financial head. Instead of having the right to imprison his serfs, the financial lord has the power only to withold from those who displease him the means of conducting their business. That is, he shuts the bank door in their face and denies them the use of the medium of exchange.

This change is a refinement, perhaps, but it does not help to free the serf. For in denying a man the use of the greatest public utility, which is the means of carrying on his business, the financial master can cause just as much loss and suffering as the old feudal master could through a more apparent power.

Perhaps the newer feudalism has been made less hateful than the old, since the outward signs and symbols of power have been discarded. Names have changed, and we no longer speak of king, vassal, and serf. The visible means of enforcing the master's will have disap-

peared, and our financial kings, dukes, and barons do not parade in regal costumes and waving plumes. And the tokens and customs of serfdom, the forms in which the serfs acknowledged openly their inferiority, and the supremacy of their masters, are no longer required.

But for all this, the subjection is no less complete. Indeed, on account of its invisibility it is the more dangerous; it is the more insidious. For the present-day tyrant is no longer responsible to the court of public opinion. Because the means of his power are not easily seen, and the results of his tyranny will be charged to other causes, he can use his power in the most cowardly way, and yet escape all criticism. He can, for instance, cause a failure in business by withholding deserved credit, and then blame the failure to the unbusinesslike methods of his victim. And instead of being censured for such an act, the tyrant is praised for his foresight and wisdom.

There is yet another way in which this modern feudalism is a greater burden and a more serious danger than was the old. Under the old system the interests of master and serf at least tended in the same direction. The more the serf produced, the more the master could require from him, and so they both desired the greatest production. But today the reverse is often the case, for frequently the interest of the financial master is allied with that of the speculator, and so opposed to that of the producer. Some may doubt this, but their doubts will be removed in a subsequent chapter, where this phase of the question will be more fully discussed.

Probably some people may resent this entire com-

parison; they think it ridiculous and absurd, or at least untrue. If they are not convinced after reading what the Comptroller of the Currency has to say in the next chapter they would possibly change their minds upon applying at any bank for a loan.

Let us suppose a man applies at his home bank for a loan. Such an application would be a request to be allowed to use the most important public utility. The first question he would be called upon to answer would be: "What are you going to do with the 'money'?" So customary has a question of this sort become that it seems now perfectly natural. But when one thinks about it a little, and sees what an assumption it makes it will be resented. For does it not assume the relationship of master and servant? Or at least that of guardian and ward?

Where the security is not of the best, so that the loan must be applied to that security in order to make it good, the question is logically justifiable; but where a man is offering ample security for the use of the medium of exchange, the banker has no right to inquire into his business. Under such circumstances the question is virtually an insult, for it assumes that the banker is the master or at least the guardian of the customer.

It is cheerfully admitted that neither the banker's question, nor his refusal to make the loan, are prompted by any feeling on his part of that of a master toward a servant, but this in effect makes no difference, for the result is the same.

Our analogy is also borne out by the fact that the answer of a baron—the small banker—when asked for

a loan, will depend very much upon how his overlord, the reserve city banker, feels toward business conditions and the future outlook; the latter's conclusions are in turn drawn from the head of all national financial power, otherwise known as "Wall Street."

In short, is there any practical difference between a system where the master owns the land, and permits his serf to work it under his direction, and one in which the master controls the medium of exchange, which must be used by the producer to carry on his business?

The feudal master controlled the basis of all industry, the land, while the modern master controls the means of carrying on all industry, the medium of exchange. Is there any difference?

Perhaps this comparison of our modern financial system to the feudal system of bye-gone days is liable to become tedious with too long a discussion, so with one more picture we will turn to further direct considerations.

An old historian saw the evil effects of the old system of feudalism, whereby one class worked in order to support the other in idleness; and, in order to show this evil the more clearly, he drew a picture to represent the conditions of the day. In this picture he showed the king standing on the shoulders of his overlords these overlords stood on the shoulders of their lesser lords, who in turn stood on the shoulders of their own vassals, the minor landholder; finally these stood directly on the back of the poor peasant or serf, who tilled the land. And so in addition to his work in tilling the soil and bringing forth a produce from it, the serf had to bear

the burden of all these successive lords and overlords, and the sovereign himself, upon his shoulders. Naturally such a weight bore him down, so that he could not even cultivate his fields properly.

The force of this picture was to show how the old system, by placing all the weight upon the one class of producers, tended to restrict the production of this class itself. Precisely the same thing applies to our modern financial feudalism. The entire weight and restriction of a bad financial system rests upon the shoulders of the producers, and hinders them, so that they are unable to carry their production even with reasonable closeness to its fullest development.

Since the object of civilization is to provide for the wants of the community with the least effort on the part of the members of the community, our present system is directly opposed to the advancement of our civilization.

It is true that the individual banker cannot be blamed for the difficulty the producer has in obtaining proper credit; the fault is with the entire banking system. But this does not lighten the gravity of the fault, nor remove its bad effects.

The weakness of the system is shown when two different institutions had to be erected in an attempt to take care of the farmers' need for credit. The Federal Farm Loan Act is but one indictment of the inadequate, inefficient, and antiquated banking system that hinders the forces of agriculture, industry, and commerce today. The War Financing Corporation and the Edge Act are recent indictments to the same effect.

And one of the chief phases of this inadequacy lies

in the autocratic power of the banker which has been the subject of discussion in the preceding pages. This autocratic power is sometimes exercised very ruthlessly.

For instance, the lords of finance recently discovered that credit inflation had caused extravagance. Even working men were spending their money for automobiles. Word was sent out that the credit situation demanded curtailment. It was not an order; it was no more than a suggestion, but no king's command could have been more promptly obeyed. Credit was withdrawn from the automobile dealers. As a result, sales contracts had to be discounted through speculators at 15, 20, and 25%. Orders for machines were cancelled. The automobile business slumped and started our present business depression. It was blamed to over-production, but it was not over-production, for the demand had not been over-satisfied. It was just the result of the automobile dealers having been thrown out of the bank.

The question is now whether we shall erect a financial asylum for them as we did for the farmers, and as is being done for the exporter, or whether the problem shall be solved in a logical, proper, and thorough way, through public control of bank credit. This question does not concern financial outcasts alone, for we are all losers by the business depression and besides, no one knows where the axe will fall next.

No personal liberty can exist so long as any public utility so vital as the medium of exchange is allowed to rest in private hands. The bad effects of private control of a great public utility were quite apparent in the old days of unregulated railroad operation, when the

officials could show, and use, their authority by refusing the shipper a car, or by charging an exorbitant rate, or by giving a competitor a rebate, or using any other means of unfair discrimination. The power of the autocratic railroad official was then easily seen, and when the evils in the private control of that public utility became so obvious, it was soon done away with.

The chains by which the banker binds us are invisible, and our rulers assume no apparent regal prerogatives; we are, therefore, lulled into believing that we have a freedom such as no people ever before enjoyed. How the real state of affairs differs from this apparent state is so obvious now to the reader that it needs no repetition.

If these evils were unchangeable, if the private control of our medium of exchange could not be done away with, if we were destined forever to live and carry on our businesses under the autocratic supervision of the financial powers, it would be of no avail to point out the truth. It would be better for us to blind ourselves to the real facts of the case, and to live on in our apparent freedom, suffering its evils patiently. But it can be changed, and we have seen how easily the change can be brought about.

The American people will certainly not permit this strangle-hold on liberty and on all productive energy to continue when they know that thirty words properly placed in the Federal Reserve Act will completely destroy the feudal power of the "Money Trust."

It will not be difficult for business men to conceive of the advantages that would accrue to them from such a

change. By it they would be enabled to carry on their business without being compelled to accept the judgment and yield to the will of the banker. Such a condition would be so foreign to present conditions that the relief can hardly be imagined. Indeed, the thought of being able to ignore the banker while using the bank's credit is so inconceivable that it may even cause the reader to doubt whether the proposed change is practicable. And yet it is, essentially practicable, and exceedingly simple to carry out, as a review will show.

The proposed measure would in essence only require the banker to extend the use of the public utility in his hands to anyone who would have a right to use it—that is, to anyone who could give proper security for a loan.

With such a change accomplished every business man could know at all times his limit of credit. He would certainly appreciate the right of being able to use his credit when and as he pleased and to conduct his business according to his own judgment without question or hindrance from any one. And this improvement in business conditions would all be accomplished through public control, which is our present method of dealing with all other public utilities.

There is no suggestion of a change in the kind of money, the institution which issues it, or the method of using it.

For if a banker today were going to make a loan on personal property such as wheat, iron, hides, wool, etc., he would accept as the value the price established by the market where such goods are sold. No change in this

method is suggested. The only change desired is that all must be treated alike by the banker. If one thousand bushels of wheat is good security for a loan of one thousand dollars to Jones, then it should be good security for a loan of the same amount to Smith; and the way the banker feels personally toward either Jones or Smith should make absolutely no difference.

In the case of a loan on land, no change is suggested except one in the method of appraising its value.

Instead of letting the banker or a bank appraiser guess at the value and charge a good sum for the guess, it is suggested that we make the personal interest of the property owners of the community settle the value through the Assessor's office in a simple and practical way with little or no expense to anyone, but with perfect safety and satisfaction to all.

These few changes are simple and obvious but once they are made any business man may know at any time how much he is entitled to borrow from the bank. He would merely have to find the value set on his property through these public agencies; then by applying to that amount the percentage of loan to value established by the state banking authority or the Federal Reserve Board he would know exactly what amount he could borrow.

For instance let us suppose a manufacturer desired to buy a thousand tons of iron. The iron, we will say, is quoted at $60 a ton, and the percentage of loan to value established on such a security is, say, 70%. The thousand tons would cost $60,000. When put in a warehouse the manufacturer would be entitled to borrow on the warehouse receipt 70% of $60,000 or $42,000. Then

to swing the deal he would only require of his own cash $18,000 and enough to pay the freight.

There would be no guess-work about this deal, no time wasted, no humility, no pandering to the banker. He could figure it all out in his office and then wire his order. When the iron was shipped he would deposit with the bank his note for $42,000 with the bill of lading attached, and with this loan, plus the $18,000 he already has, he pays cash for the iron, and is thus enabled to take his discount or the transaction could be handled through an acceptance.

Similarly a merchant who might want to buy a thousand barrels of sugar, or other merchandise, could do it in the same way, and without any uncertainty or worry either for himself or the banker.

Since the use of the medium of exchange would be a right which he could always take advantage of, so long as the value of the security given did not fall, these notes could be renewed indefinitely. The only requisite would be that the margin of security be maintained and the interest paid.

Such a procedure would probably seem strange for business men. They would feel unaccustomed to their new freedom, and hardly be able to realize that they could go ahead without telling all their business plans to the banker and then worrying whether he would let them have the money. But the habit of deferring to the banker would be overcome in time, and we would gradually learn to get along without a guardian. And what a relief it would be! Especially in the knowledge that the banker would have to renew the note as long as

the security were kept at the required margin and the interest paid when due.

As to the right or wrong of the proposed change, the right is entirely on the side of public control. For bank credit has gained its position as our medium of exchange only through the laws which the people make. Through our laws the banker is enabled to exercise a function which properly belongs to the government.

Instead of the proposed change taking any property or any rights from the banker it is just the reverse.

The banker is a trespasser on the peoples' rights. Through the development of the banking habit, aided by our banking laws, the banks have usurped the most important government function, that of money control.

There is no more reason for allowing the banker to continue this trespass than there would be for permitting any body of private citizens to move into one of our public buildings and use it for their own purposes to the exclusion and detriment of the public.

There is not the slightest justification for our present banking system nor any reason why the banker should continue to be our lord and master, and so there can be no possible objection to the proposed change as a matter of principle. Indeed, the very opposite is the case.

For since it is through our laws that bank credit has become our greatest public utility, and since its value is derived entirely from those laws, it is not only our right, but our bounden duty, to put it under public control. It is public property. It belongs to the people in common and, therefore, it must be at the service of all on the same terms.

CHAPTER X

INTEREST

There may still remain some among those who read these pages who doubt the validity of the indictment contained in the preceding chapter. Perhaps they feel that nothing sufficiently official or authentic has been cited to prove the case.

If this be so then their doubts will soon be dispelled in the succeeding few pages. Here they will find indisputable evidence of the feudalistic power now in the hands of our present day masters, the banking interests, and of the ruthless and destructive way in which the power has been and still is exercised.*

This evidence is to be found in recent reports of Mr. John Skelton Williams, Comptroller of the Currency of the United States. Were it not for his official position and the sound facts which called them forth some of his statements would sound like the ravings of a soap-box reformer or the scare-headlines of a propagandist journal. Coming as they do, however, from such an authoritative and responsible source, they cannot but be accepted as authentic.

Among the most recent of these is a statement given by the Comptroller to the press—a statement which, as would be expected, raised a howl of vigorous protest. In this statement Comptroller Williams exposed the fact

*See Appendix Page 302.

that the rates for call money used by New York banks are fixed by a committee of brokers on the New York stock exchange. Among the evils resulting from this practice he pointed out the fact that since the rate on call money affects prices, especially the prices of bonds and stocks, the committee is thereby enabled to determine the trend of prices and to quickly effect the prices of securities. Having in this way an "inside" knowledge of how security prices are going to move, or rather, being thereby enabled to influence the movement of these prices, this committee of brokers has the opportunity of profiting largely, and without risk, by operations on the stock market.*

Glaring as such a fault is, however, it is only one of the lesser evils that result from this improper concentration of power in the hands of a few. The Comptroller pointed out a still greater objection to the practice in the fact that, by raising the rate on call money in the financial center, money which otherwise would be used to stimulate legitimate business and to foster production in other parts of the country would be attracted to New York and used for speculative purposes. In this way the practice resulted in defeating one of the primary purposes of the Federal Reserve Act, namely, the orderly distribution of money throughout the country to meet the needs of commerce and agriculture.

As was to be expected, this statement of the Comptroller raised a vigorous storm of protest from the bankers. For doing his duty in pointing out a very glaring defect in our financial system, Comptroller Wil-

*See Comptroller's statement printed in the Appendix.

liams was severely taken to task at the meeting of the American Bankers Association which condemned his plain statement of facts, as a "dangerous attack on the credit structure of the country."

If any comment is at all necessary here, it will be sufficient to remark that, to an impartial observer, such a condemnation indicates a very tottering condition of the country's credit structure. If our banking system is so shaky that a plain statement of what any one will readily recognize as a very harmful and eminently unjust practice, can be called "a dangerous attack on our credit structure" it is about time to put that "credit structure" upon a more solid basis.

The solicitation of those bankers for the safety of our credit structure may have been influenced somewhat more by personal interest than by patriotic motives. It has been a rather common practice for the masters of all ages to appeal to fear of national calamity or to hide personal interest behind patriotic motives in order to save their privileges.

Indeed, if the foregoing statements have such dangerous possibilities, what must have been the danger of other statements made by the same Comptroller, at an earlier date. For not so very long ago the Comptroller had occasion to call a number of banks to order for practicing usury. The idea of usury is generally connected with the Middle Ages, when the exaction of any interest at all on loans was unlawful; and where the money-lenders, running as they did the risk of extreme punishment, charged excessive rates to make up for the danger.

In the minds of most people, then, the practice of

usury is thought of as being one of the abuses of the Dark Ages, together with such things as the Spanish Inquisition, The Star Chamber, and so forth. The facts, however, are far from this. For not merely a few banks, but more than one-third of all the national banks in the United States were convicted on their own sworn statements of charging usurious rates of interest, running, in some instances, as high as two hundred per cent a month, or more than two thousand four hundred per cent per annum.

Certain parts of the reports of the Comptroller of the Currency are so interesting that they are well worth being reproduced here.

In regard to the City of New York, the financial center of the country, the Comptroller of the Currency said:

> "It is the walled city from which the barons have levied tribute on a territory and population vaster than any king of the Middle Ages dreamed of, yet sometimes using methods as ruthless and savage as those of the robber nobles . . . forays and levies devasting by scientific, artful methods; pillaging under form of law, smiting with swords that bite deep, though we can not see them, consuming with fire which comes invisible and unsuspected."

Does anybody need a stronger confirmation than this of our indictment of the present financial system as being a stronghold of feudal power and practice?

To proceed with the Comptroller's statement, he claims that "there is no natural limit to greed and the ambition to acquire," offering as proof thereof the following:

"Sworn reports, made by the banks themselves, show that on September 2, 1915, 2,743 national banks, out of a total of 7,613, were guilty of usury. This at a time when the Federal Reserve banks were offering money freely to national banks in every part of the country at rates varying from three and a half to five per cent.

"Such a policy is bad and dangerous, even in the business centers where borrowers are men of experience and skilled in business, but the real brutality and horror of it develops in the rural districts. Some reports from the South and West, the Northwest and the Southwest, are blood-curdling. They are like stories from darkest Russia; like the ghastly wrongs done the French country people by the old nobility. The small farmer or planter is usually poor and without money to employ lawyers or the instruction to understand his own rights. Because of this helplessness, he falls an easy victim to the rapacity of the unscrupulous money lender, and goes to a destruction that his energy and honesty do not deserve."

Nor is this merely an empty indictment, unsupported by direct proof. In support of his statements the Comptroller gives a few typical examples which are interesting if for no other purpose than to prove that greed has no natural limits. For instance he says:

"I have the record of the loans made by one Texas national bank to a hard-working woman who owned a little farm a few miles from town. She borrowed, in the aggregate, $2,375, making about thirty loans during the year. Listen to the details of the robbery:

$162.50 for 30 days at 36 per cent: $377 for 34 days at 44 per cent; $620.25 for 23 days at 77 per cent; $11 for 30 days at 120 per cent; $21.50 for 30 days at 90 per cent; $33 for 2 days at 93 per cent; $27 for 15 days at 195 per cent; $110 for 30 days at 120 per cent—that was to buy a horse for her plowing—$20 for 48 days at 187 per cent; $6 for 10 days at 720 per cent; $7 for 3 days at 2,000 per cent; and so on; every cent paid off by what sweat and struggle only God knows."

As an exceptional instance, this statement might not be of such overwhelming concern, since the loans were small. But it is not an exceptional instance. In that state alone 192 banks out of 534 were found guilty of usury, charging all the way from twelve to two hundred and fifty per cent on the money they could get from the Federal Reserve Bank for from three and a half to five per cent.

Another instance cited by the Comptroller is equally interesting:

> In Oklahoma, where the legal rate of interest is six per cent, with ten per cent as the maximum under special contract, harassed farmers paid all the way from 12 to 2400 per cent with 40 per cent as the average. In the case of one bank, Mr. Williams proved that not a single solitary loan had been made under fifteen per cent. He cited one particular case that he asked to be regarded as typical. In the spring the farmer went to the bank and arranged for a loan of $200. Out of his necessity he was compelled to pay 55 per cent interest charge. Unable to meet

the note at maturity, he had to agree to 100 per cent interest in order to get the renewal. The next renewal forced him up to 125 per cent. For four years the thing went on, and all the drudgery of the father and the mother and the six children could never keep down the terrible interest or wipe out the principal. As a finish, the bank swooped down and sold him out; the wretched man, barefoot and hungry, went to work clearing a swamp, caught pneumonia and died; the county buried him, and neighbors raised a purse to send the widow and children back to friends in Arkansas.

That such a condition of affairs should exist in this twentieth century of enlightenment would not be believed, were it not for the authenticity of the source from which the information comes. But what is still more surprising is the fact that this charging of usurious interest rates does not comprise the sum total of the abuses. For while the Comptroller has stopped the particular abuse we have discussed so far as lay in his power to do so, and while no national bank has since dared to report a usurious interest charge, the abuse has not been done away with entirely. For the banks have several other ways of "beating the game" and achieving the same abusive results, regardless of Comptrollers or of state authorities.

One of these, for instance, is where the banker directs an unsuccessful borrower to a broker. For instance, when a borrower appears, the banker either demands a bonus, or gives some reason why he cannot handle the loan. Pretending, however, to be desirous of helping

the customer, and hiding his deceit under the mask of friendship, he refers the would-be borrower to a broker who, he says, may be able to secure the loan from outside parties. Of course, there will be a little brokerage fee of from two to five per cent, and the money-lenders want a little higher rate of interest than the banks.

Flattered by the banker's interest in his welfare, the helpless borrower takes a card to the broker. The latter, really a stool pigeon, goes into the back door of the bank and secures the funds with which to make the loan.

The advantages of this method are apparent. The bank escapes the odium of usury. The official who turns the trick does not have to divide his rake-off with the stockholders of the bank in which he is employed. And the borrower's resentment is turned against the stool pigeon instead of the banker. High class bankers no longer consider this method "ethical," and they do not practice it. This makes little, if any difference, however, for they have an "ethical" method of putting on the screws. This is by requiring the borrower to keep his balance at a certain figure.

If the borrower gets a loan of ten thousand dollars it is with the understanding that he is to maintain a balance in the bank of from two to four thousand dollars. That is, the borrower is required to keep from one-fifth to one-third of the amount he borrows always on deposit in the bank; so if he really needs seven thousand dollars he must borrow and pay interest on at least ten thousand which, of course, raises the rate on the money actually used and what appears to be six per cent money is really nine or ten per cent money.

This practice is considered perfectly "ethical," and it is so common that bankers have evolved a rule by which they figure how much a man is entitled to borrow. The basis of the problem is the average monthly or yearly balance the borrower has carried in the bank and the answer is about four or five times that balance.

Thus a business man who has carried a bank balance of $2,500, paying interest out of his own pocket on any loan, while his balance lies there idle, not drawing a cent of interest or at best a low rate of interest, would be figured as good for a loan of about $10,000. If his balance were $5,000, then he might get a loan, on the basis of this larger balance, of $20,000 or perhaps more.

These are a few of the methods by which our modern feudalistic masters grind out their wealth from the toil of their serfs. Can anyone still doubt the claim that we are living under a modern autocratic regime that is rather more than less dominant, ruthless, and terrible than that of former ages?

When we read of the grinding taxes imposed upon the common people by the autocratic government of the Bourbon Kings of France, we wonder more at their long patience than at the result of their final desperation, which ended in the Reign of Terror. The people of those days were no different from what they are now. There were good and innocent Frenchmen among the aristocracy who protested against existing injustices, and there were high-spirited, intelligent and liberty loving people among the down-trodden commoners; but a courageous and intelligent peasant remained helpless against tyranny, because his neighbors lacked the force to assert

their rights and the courage to organize. The peasants who would have started an uprising were bound by the inertia of the others. Constant pressure of wrong finally overcame this inertia and the righteous wrath of the people was finally kindled into an all-consuming flame which spared neither innocent nor guilty among the governing class.

If this bit of history teaches anything, it is that the crime of one of a class, or an injustice to one of a class, in the exercise of a public function, is the crime of all that class, and an injustice to all of the other class.

And from the statements it will be seen that even if we are not personally and directly affected by the abusive practices current under our present financial system, we are, nevertheless vitally concerned. Whether or not we are, individually, affected by a particular act at a particular time, we are at any rate greatly concerned in an indirect way. For if the weeds of greed, injustice, and oppression are permitted to grow at all, their seeds will soon produce more and more weeds, and the whole garden will soon be ruined.

The few illustrations given by the Comptroller serve to show that autocratic power in modern America has the same tendency toward cruelty, injustice and disregard of the rights of others that it had in France prior to the French Revolution.

And this is not all. For it is not the flagrancy of the cases cited, nor the question of whether few or many suffer, that is of greatest importance. Essentially it is a matter of principle. The greatest evil lies in the fact that the system allows of such abuses. And this is not

modified by the fact that the particular abuse has, to a great extent, been allayed. For its correction was an accident. It happened as a result of the appointment of an efficient, and fearless Comptroller of the Currency.

In fact, the matter of interest, and all the abuses which we have seen are possible, and have existed, under the present system of banking are really only of minor concern to us. For evil as are their effects, they arise from a condition which is in itself merely the effect of a still more vital evil, the fault that lies at the heart of our financial structure.

This is, once more, the private control of the greatest of all public utilities, the medium of exchange. This private control is the root in which all evils, such as we have been discussing, and others too countless to enumerate, find their origin. And these and other abuses will be continued, and will forever crop out in new and terrible forms, regardless of all governmental restraint, however well-intentioned, that is aimed at the effect and not at the cause.

These and many other abuses can be prevented only by removing their cause. The whole matter of interest or discount, excessively injurious as it may be, is but a matter of minor importance. The real concern is the matter of private control, from which all the other evils spring.

And once more it can only be said that the marvel is not that the evils are so great, nor that their effects are so far reaching, as it is that they are allowed to exist at all. It is so apparent that our medium of exchange is merely a system of keeping track of credits and that the

whole system rests on the people's laws and is, therefore, the people's property that our present system seems a slur on American genius and business ability. It is also so plain that it is our greatest public utility, that it seems incredible to see the American people submitting to tyranny and abuse due to its private control. Especially is this so when the remedy for all these evils is such a simple one. Thirty words to be added to the Federal Reserve Act, would do away with the rottenness at the core of our present commercial and industrial structure, and thereby kill off all the weeds and cankerous growths that find their origin in that festering center of unrestrained private control.

THE GOLD STANDARD

CHAPTER XI

When we read of the misguided individuals who, in past ages, believed in witchcraft and sorcery, who worshipped idols, and who fanatically killed each other in the name of religion, we are inclined to pity them. We look down upon these former ages from our heights of enlightened opinions and our great scientific and material progress, and congratulate ourselves that we have become emancipated from ancient and ridiculous beliefs.

And yet at the same time we have in one metal an idol which we worship with no less intensity than did the people of past ages worship their graven images. An idol, furthermore, which is raised on grounds no less fallacious than the idols of old; but one, the worship of which is far more destructive in its effects upon the real progress of the world than were all the heathen creeds and practices of all past ages.

This idol is gold, and the pedestal on which it is raised is the fallacy of the gold standard. It rests upon the idea that there is an essential difference between gold and all other things, a difference which gives this one thing, gold, certain peculiar properties by which it has certain power over all other things.

The subject of the gold standard is mentioned here with the intention of divorcing the human mind from these ideas. In the suggested remedy, no mention has

been made of the gold standard or of anything connected with it and none is necessary. For, as the remedy rests upon the foundation of truth all means used to deceive and, all false standards will automatically disappear.

The United States, as well as all other progressive countries, has adopted the gold standard. Our finances are said to be on a gold basis, meaning that our currency is based on gold as the money of ultimate redemption. Now to a certain very limited extent this statement may, guardedly, be taken as true. Unless, however, it is taken in this very limited sense, it includes such a multitude of untruths that it becomes the foundation of a very great fallacy.

For it leads to the belief that gold is somehow above all other commodities, and by its very nature in a position superior to them. Whereas in truth gold is a commodity, just as lead and iron are, having certain peculiar characteristics of its own, as every other commodity has; but differing in essential principle not a whit from any other commodity. For it obeys the same natural laws, from the law of gravity to the laws of value and price. Without entering here into a discussion of the various theories of value and price, it will be sufficient to explain this statement as meaning that gold, just as every other commodity, has a real, or true, value, which varies according to certain natural phenomena, including demand and supply. Just as, roughly speaking, demand and supply determine the real value of any other commodity, so they determine the real value of gold.

The truth of this is somewhat obscured by reason of the fact that gold, having been used as money for many

centuries, has had its price fixed by law. That is, the weight and fineness, or the amount of pure metal, to be put into various gold coins, has been fixed and these coins have been designated as of a certain value. The significance of this fixed price is, therefore, that it practically assumes that gold is the standard of value.

It is a standard in so far as the prices of other commodities are quoted in or referred to its price, but as its price is not stable it is not a real standard. History testifies that it has been necessary to readjust the fixed price of gold many times within the past six hundred years. If gold were in itself the standard of value, these changes in its price could hardly have happened.

Furthermore, the use of gold for other purposes than its employment as a money metal—that is, the use of gold in the arts shows, in its effects upon the gold coin in circulation. The real value of gold varies according to the demand for and supply of it. The price of gold as fixed by law in the United States today stands at $20.67 per ounce. If the production of gold should fall off very greatly, so that the needs of goldsmiths, jewelers, and dentists could not be adequately supplied, these people would be willing to pay more for it. That is, its market or bullion price would rise. Suppose it rose above the money price, say to $22 an ounce. Then gold as bullion would be more valuable than gold as coin, and coins would be melted up and disappear from circulation.

Again, gold always seeks the country where the demand is greatest, where people are willing to pay the highest price, that is, give up the most goods, for it.

All these facts go to show that the real value, and, therefore, the true price, of gold fluctuates according to the supply of and demand for it, just as does the price of every other commodity. Consequently the effect of fixing the price of gold at one dollar for 25.8 grains of gold nine-tenths fine, at the mint, is no different in principle from the effect of fixing the price of wheat at two dollars a bushel in Chicago, or the price of iron at four cents a pound in Pittsburg.

It is the fallacy, however, that there is a difference between gold and other commodities, a fallacy which has endured throughout the ages, and that has been the cause of countless unfortunate misunderstandings. And these misunderstandings will continue to exist until the fallacy has finally been done away with.

The origin of this fallacy is not hard to find. It arose because of the peculiar fitness of gold to be used as a medium of exchange at a time when commerce was still small enough not to be restricted by its use. For, as will be remembered, to render efficient service a medium must have universal acceptability and proper elasticity. Gold has universal acceptability, and consequently, so long as commerce did not grow to such proportions that the lack of elasticity of the gold supply hindered its development, gold formed a fairly good medium of exchange. As a result of this acceptability and because its value fluctuated the least of all commodities, gold came into universal use as a medium, by which value is measured and goods are exchanged. It was but a short step—however fallacious, to attribute to gold the attributes of money (as distinct from the

medium of exchange); that is, to regard gold itself as the standard of value.

And bound up with this fallacy, in that it depends for its existence upon the gold standard, is still another fallacy, namely, the assertion that gold is the money of ultimate redemption. This fallacy, as we have seen, arose through the development of credit as a superstructure on a medium of exchange composed largely of gold, the purpose being to supply the lack of elasticity from which gold suffers.

Now it is true that a balance of trade is sometimes settled in gold. For instance, if the United States sends to England meat, raw cotton, and wheat greater in value than the fabric and textiles England sends to us, then the difference may be settled in gold, since this is a universally accepted medium.

But the statement that gold is the money of ultimate redemption is a different proposition. It means that all the currency of the United States, including gold and silver certificates, silver and fractional coins, may be exchanged for gold at the United States Treasury at the option of the holder. It means, too, that bank deposits and other debts are payable in gold.

Now, as already stated, this is true in a limited sense only, that is, so long as too many persons do not try to avail themselves of the promised exchange at the same time. For if the people should attempt to make the exchange in any great quantity as they have several times in the past the promise would be found to be entirely a fiction. Since the days when gold was really used as a medium of exchange, instead of a phantom to

bolster credit as it is now used, the volume of trade or business has increased many fold, while the increase in the amount of metal has been entirely inadequate. And now with the amount of gold practically a fixed quantity, while the volume of credit is piling up every day, the percentage of ultimate payment money to bills payable will soon reach the vanishing point.

The history of finance is largely a list of the various deceits and devices that have been used to cover the fact that the promise to pay in gold could not be fulfilled. Its path is strewn with the wreckage of government paper money issues, asset currencies, greenbackism, bimetalism, and a varied assortment of banking systems and legislation induced by bank failures and panics. Altogether it is a sorry story, filled with miseries and repeated failures, all due to a lack of understanding of basic principles and of the first requisites of a medium of exchange.

But regardless of the amount of trouble that this fiction of ultimate gold redemption has caused, it is really only a minor point. It is one of the excrescences of the real evil at the bottom of all evil which is the private control of our medium of exchange. As has been shown, the gold standard merely intensifies this evil. Since the promise to redeem in gold cannot be fulfilled, it need not be considered, in arriving at an intelligent solution of the financial tangle. It is necessary, however, that the solution shall so completely eradicate the basic evil that the resulting fallacies will also disappear. As has repeatedly been shown, the suggested remedy thoroughly fulfills this requirement.

But the fallacy of the gold standard is of exceedingly great interest in illustrating the hold fiction such as this can gain on the minds of the greatest authorities, and as an example of how such a false promise confuses what is really simple and clear. It furnishes an explanation as to why our present financial system seems so intricate and unintelligible and the depth of the deception is realized when one sees this fallacy treated as the truth by eminent authorities on money and banking.

An example will bring this point home so clearly that an examination of it is highly interesting as well as instructive. This is furnished by an address made before the Ohio Bankers' Association in 1905, by Leslie M. Shaw, Secretary of the Treasury from 1902 to 1907.

In this address Secretary Shaw is reported to have said:

> "The fact, and I think it is a fact, that the United States has the best currency in the world does not imply that the currency system of the United States is perfect, or that it cannot be improved. It is as safe as any system in the world because it is established on the only safe basis known to man—*the gold standard.*"

The double standard of gold and silver at the ratio of sixteen to one was in force until 1873, when the country adopted the gold standard. But panics continued to occur every ten years as before, which would argue that the gold standard is hardly the great tower of strength and safety it is here claimed to be. Mr. Shaw continued:

"The United States dollar is worth not only one

hundred cents, but one hundred gold cents. The dollar is worth 25.8 grains in gold. That measures the market value of our dollar. Whatever 25.8 grains of gold will buy our dollar will buy, and it is worth precisely the same uncoined as coined, for the Government stands ready to coin it free and in unlimited quantities."

All these statements are apparently true, but fundamentally misleading, because a dollar is worth one hundred cents worth of any commodity and gold is only a commodity not one whit different from any other. To be sure the price of gold has been fixed by law for many generations, which may add to its dignity; but during the Food Administration we saw many other commodities, such as wheat, have the same dignity bestowed upon them.

In less than two years after Mr. Shaw made this claim of the solidity of our financial system because of the gold standard, the country was using clearing house certificates under pressure of continued holidays declared by the governors of the several states. What difference is it whether 25.8 grains of gold is worth a dollar, or a bushel of corn is worth a dollar? It is a distinction without a difference.

But Mr. Shaw did not stop here. He went further:

"Then in addition, every dollar of our currency, gold certificates, silver, silver certificates, United States notes, Treasury notes, National Bank notes, subsidiary silver, nickel, and copper coins, is redeemable in or exchangeable for gold at the will of the holder."

This statement is true only when the aggregate holders of these various other kinds of money do not wish to exchange them for gold. It is not true when an occasion arises in which they would wish to make the exchange, but even if the statement were true Mr. Shaw completely ignored bank credit, which constitutes more than 95% of our medium of exchange, while everything he mentioned constitutes less than 5%.

Continuing Mr. Shaw said:

> "This fixes the stability of our currency. Its value does not and can not fluctuate."

If by the use here of the word "currency" the secretary intended to confine his statement of gold redemption to the "government issued" money alone the statement might be true. The government possibly could redeem enough "currency" used in this narrow sense to hold it at par, but since government issued money, including gold, constitutes less than 5% of our MEDIUM OF EXCHANGE, the statement, even if true, is to say the least entirely misleading.

Continuing Mr. Shaw then admitted:

> "The system is not perfect, largely because it is non-elastic. It fails to respond in volume to the changing needs of the seasons and localities. Attention has been called to the non-elastic character of our currency many times and by many people, but that there will be no further currency legislation until we shall have experienced a panic occasioned by this want of elasticity, I am fully convinced."

This prophesy that Congress would do nothing to improve a very defective financial system, although pub-

lic attention had often been called to its defects, proved true within two years after it was made, when the panic of 1907 caught the country unprepared. In fact, no remedial action of importance was taken until six years after the panic of 1907, when the Federal Reserve Act was evolved.

As Mr. Shaw also prophetically said:

> "The country does not appreciate the danger, and until the danger is fully understood no remedy will be applied."

This still remains true. The danger has never been understood, so no remedy could be applied that would attack and remove the cause of the trouble.

Starting out with such assurances of the safety and stability of our currency, it seems strange that in the midst of so short an address the former Secretary should follow immediately with this statement:

> "A glaring defect at a vital point will sometime, sooner or later, assert itself. Meantime a remedy should be discovered, discussed, and, as far as possible, agreed upon, so that it may be promptly applied when the people are ready for it."

Mr. Shaw was not alone in knowing that a glaring defect existed. However, he could neither locate nor define it.

In his search for a remedy he discarded "Asset currency" as commonly understood, and was correct in so doing, because no method had been devised for issuing asset currency on a safe basis. Emergency currency in the form of clearing house certificates, he condemned in the following words:

"The United States originates more commerce than any other country, but our chief commercial city is not the world's clearing house. It ought to be, but it is not. One reason why it is not is the fact that it has sometimes resorted to clearing house certificates, which is a plea of guilty to an indictment charging bad management locally or bad legislation nationally, and the financial world charges both. Clearing house certificates must never be authorized by law."

The suggestion here that with a strong financial system New York would become the world's financial center should be noted.

The remedy suggested by Mr. Shaw was to provide an "emergency currency" by permitting the national banks to increase their government-bond-secured note issue up to fifty per cent over their bond security on which excess the bank should pay a tax of five or six per cent and the government, in consideration for the tax, should guarantee the redemption of the issue.

His remedy proposed that the printing on the bank notes be changed somewhat so that the extra notes could be slipped into circulation without attracting attention. The last sentence of Mr. Shaw's suggestion should be carefully noted. It is a most complete but unconscious indictment of our system. His proposed remedy for a "vital defect" was as follows:

"By eliminating the one statement on the present bank note, 'This note is secured by bonds of the United States,' the additional currency could be made identical with that based on Government bonds. The Comptroller of the Currency and the bank issuing

the currency would alone know of its existence. It would not advertise its existence or our extremity."

We are not criticising Mr. Shaw's remedy, which was tried in a little different form by the Emergency Currency Act of May 30th, 1908, and which has in a changed form been utilized by the Federal Reserve Act. But the suggestion that stealth and secrecy are necessary to the successful operation of a proposed remedy for our financial ills completely condemns the system. Stealth and secrecy should have no place in a democratic government, and a financial system, which because of its weakness is compelled to make use of star chamber methods, is a menace to liberty as well as industry.

This address of former Secretary Shaw, which starts with such a brave defence of the gold standard and the stability of a financial system based on it, proves on analysis to be a sweeping condemnation of both. Although using his best endeavor to defend and even glorify our financial system, he proves conclusively that the gold standard fetish is a lie and that the financial system based on it is weak, dangerous and degrading. Weak because the silly promise of gold redemption makes our currency non-elastic; dangerous because "a glaring defect at a vital point" (meaning the gold redemption lie) will some time, sooner or later, assert itself, meaning that a panic will ensue when the lie is discovered by the people; and degrading because deceit must be resorted to to cover up the lie. The suggestion that a remedy must be stealthily and secretly applied is an unconscious acknowledgment that our whole exchange system is conceived in error. Coming from the

source it does it proves that the financial world is just as much in the dark as the rest of the community regarding the weakness in our financial system. Apparently our statesmen and financial leaders have never seen the real cause of the unfavorable phenomena which reveals itself in the form of non-elasticity, money shortage, lack of efficiency, industrial turmoil and social unrest.

Here we see a man, holding the most important financial position in the United States, addressing financiers, the Bankers' Association, starting with a congratulation as to the strength of our financial system and ending with a suggestion that stealth and cunning are necessary to overcome a "vital defect." If this paradox were intended, financial humor is certainly subtle.

CHAPTER XII

SPECULATION

Because of the fact that the trade centers in various staple commodities—the wheat pit, the cotton market and the stock exchange, have been the scene of the gain and loss of immense fortunes, most good folk have come to consider these places as dens of iniquity run by unprincipled crooks. As a matter of fact, however, this is not the case, for the trade that goes on in these centers has a distinct economic value. Were it not for these market centers trade would be much more diffiicult, eratic and uncertain. By taking the risk of gain or loss off the shoulders of the producers, the speculators give a degree of regularity to commerce. And the brokers operating in the various markets are equal in honesty to any other class of business men. In one aspect, indeed, they are even more reliable, since they must abide by the rules of the exchange mart in which they deal.

But while the brokers themselves may be honest, there is at least one great trade center in which the game is not fair, because one set of players has a distinct advantage over the others. One party controls the wheel of fortune, as it were, and consciously or unconsciously, regulates it to suit certain interests.

The trade center referred to is the New York Stock Exchange, and the party referred to includes the bank-

ing interests. The unfair condition here arises partly from the custom of buying stock on margin, as will be explained, but its real origin lies in that same defect in our financial system that we have come to recognize as the fountain head of so many and such great evils afflicting our modern industrial community.

The evil in the stock market is but another bad result of the private control of bank credit, by means of which the banker, being able to withold loans regardless of their merits, is enabled to influence prices and in fact regulate the whole current of business. It is cumulative evidence that the banker dictates every man's chance for financial and industrial success.

Not all the havoc of the stock market, however, can be blamed on the banker. We must remember that he is not a free agent for his acts are controlled by the reserve requirement. When he gets up against his reserve his credit "freezes" and when quite a number of them arrive at the zero point about the same time it sends a decided chill down the spine of "Wall Street."

There is one condition noticeable in the stock exchange, however, which points to an unfair control of this game. This condition is the constant fluctuation in prices of stocks.

It is not uncommon to see the price of the stock of well established corporations which have been doing a steady business for years and paying regular dividends fluctuate several dollars within a very short time. The price of such stocks may fall violently one day and recover the next, and a week or a month may show a very wide range of prices.

It is perfectly clear that such fluctuations cannot be due to any change in the real or intrinsic value of the stock. Neither the business outlook of the corporation nor the state of its prosperity could possibly change with such kaleidoscopic rapidity as the prices quoted on the exchanges would suggest, so these fluctuations in price are not due to the changing value of the stock but are due to the change in the money market.

By intrinsic value is meant the actual or real value of the securities, dependent, of course, upon the dividends or interest paid on these securities, coupled with the safety of the principle invested. The market value is, as the name indicates, the price at which the securities are bought and sold.

This market value may, and almost invariably does, differ from the intrinsic value, and it may do so to a very pronounced degree. The existence of speculation in securities arises entirely from this difference between intrinsic and market values.

It is the fluctuation in price that attracts the gambler and makes a game of chance of institutions necessary in our business and commercial life.

As has been shown prices fluctuate with the volume of the medium of exchange in circulation and with the interest or discount rate charged for its use. We have seen that these two factors are entirely in the bankers hands, considering of course his limitations. If we can hold these facts in mind, while we examine another factor which contributes strongly to making a game of chance out of all investment and business, we will see just what is at the bottom of price fluctuation and how

the stock exchange, cotton exchange and wheat pit are turned from legitimate markets into gambling games.

The other factor above referred to is the trading on margin which makes up a considerable proportion of the deals on these exchanges. When a margin purchase is made the customer does not put up the entire purchase price of the securities, but only a portion thereof, say twenty or thirty per cent. The broker carries the balance—virtually loans it to the customer, charging interest on the amount carried.

If the stocks dealt in happen to be reliable industrial, railroad, or mining stocks, the broker can take the securities which he has purchased for his client, to the bank, and put them up as collateral for a loan of the difference between the margin put up by the customer and the price of the stock. The broker borrows this money from the bank on call, and lends it to the customer on margin. That is, at the expiration of the number of days notice agreed upon, the banker can call upon the broker to repay the loan. This notice, as agreed upon, may be for one, two, three or more days. On the other hand, the broker requires the customer to keep his margin good. If the price of the stock declines, the customer must put up additional payments to keep the same margin or he will be sold out.

Now here is the way in which the banker secures his unfair advantage. Supposing, for instance, the customer buys 1,000 shares of steel at $100 per share and puts up a twenty per cent margin, or $20,000. The broker may now do either of two things. If he is square, he will actually purchase the stock for the cus-

tomer. Otherwise he may, as the term is, "bucket the order," that is, he will give the customer a receipt for the 1,000 shares, without actually purchasing them; he will be taking chances on being able to buy the stock later on at a lower price, and pocket the difference; if the stock should go up, he would have to lose the difference.

But let us suppose that the broker is honest, and actually purchases the stock. Putting up the twenty thousand dollars received from the customer, he will order the stock to be delivered to the bank: on it, as security, he will borrow the balance of eighty thousand dollars and pay for the stock.

Here the broker is in the clear. He runs the game, and his profit consists entirely in the percentage which he takes as his commission or brokerage, just as does a pool seller on a horse race. His profit being certain, the price of stocks makes no difference to him so long as he conducts a legitimate business. His only interest lies in the volume of business on the stock exchange.

The real game is between the banker, who puts up the eighty thousand, and the customer who puts up the twenty thousand. The only interest the banker should have is to get his money back with interest. But, as is most likely, he may be playing the market a little himself; or perhaps some of his clique desires to obtain a little stock at a cheap price.

Now suppose the money market tightens up, supposedly due to any one of a great number of reasons assigned by our financial lords, but in reality due to the fact that our rulers at the financial center have caused

it through cupidity or fear or because the limit of credit has been reached. Just a word is sufficient as we have seen in the case of automobile credits.

The banker adds to the money shortage by calling in the particular loan of eighty thousand dollars along with other loans aggregating several million.

Neither the broker nor the customer can borrow money in a tight money market. Others are in a similar position, and their efforts to borrow lessens the value of the security offered, the price of which falls on the exchange.

As a result, the broker must call on his customer to put up more margin. Some are able to do so, but others cannot. The broker has to sell the stock to pay the banker's loan; the customer is thus squeezed out, and the stock, thrown on a declining market, accelerates the decline, and results in a call for more margin from those still in.

More customers are frozen out, until finally the price reaches bedrock. Now the banker and his friends, the big traders, step in, and grab the stock which the customers could not protect by putting up the margins. The tight money market and the resulting stock flurry are a result, merely, of the fact that the banker had stopped his mint: he ceased making loans. Now that his clique are in possession of the stocks, he again lends money, or in other words, mints bank credit. With this, his friends, the inside ring, buy more stock. As a result, the prices go up and soon the market is ready for another set of customers who come to be divested of their money, as sheep to the shearing.

The game is well arranged, and certainly more dignified and orderly than a horse-race, for it runs during every business day in the year, and its results are more certain than the results of the races. The banker has a handle which operates this wheel of fortune, and which practically eliminates the factor of chance or uncertainty, as far as the insider is concerned. This handle is known as "call money." It works like a pump handle. When it is pushed down, that is, when call money is cheap, up go stocks. When it is pushed up, that is, when the banker refuses to make loans, or the discount rate on call money is raised, stocks go down.

Every one knows that the more rapidly you move a pump handle up and down the more water you pump and it is just as certain that the more rapidly you move prices up and down the more gambling you produce. Of course, the brokers all know this, and some of the bankers may, and in order to make the game lively, and increase their profits, the bankers of New York allow a committee of brokers on the stock exchange to fix the rate on call money. This committee pumps vigorously by varying the rate from five or six to as high as thirty per cent. It is fixed every day and all the banks are notified of the change. This makes the price of stocks fluctuate and gives the insiders a chance to get their money down right.

No doubt there is some reason for changes in the rate on call money, but if it were not changed prices would not fluctuate so rapidly nor so violently and the gambling element in the country would not be attracted. In that case the business of these trade marts would be greatly

decreased for the business would be confined to legitimate trade.*

As the banker alone controls this handle, he likewise operates the wheel of fortune. But as the brokers depend on the amount of trade or the turn over of the exchange and as this volume depends on the gambling spirit excited by the fluctuations in prices it is both convenient and effective to have the call money rate fixed by the brokers.

We headed this chapter "Speculation" but the result of operations on the exchange seems to be almost too definite to be so designated. This game, if we may still consider it a game of chance, has several advantages over others we have known. For instance, none of the players see each other, and no one is to blame, and so no sympathy is wasted on the losers. The broker, the only man in sight, has collected two commissions—one for buying the stock, the other for selling out the customer. The stock is back to its former price, and the only difference is that the customer's money is in the pockets of the banker or of his friends, the insiders.

To point out this aspect of the game to the banker, and show him that he had committed a most cowardly robbery, would hurt him and surprise him beyond measure. We should not blame him, for he is a most respectable and kindly gentleman, and this aspect has never occurred to him. In fact ignorance is the only excuse that can be advanced in his favor. He operates the pump-handle for the most part unconsciously, so in

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*See Appendix.
(Note changes reported by Comptroller) Page 306.

the operation of the game the banker is generally innocent of any evil intent.

Reserve requirements are for the purpose of perpetuating the belief that credits are payable in money and for the purpose of continuing the gold standard fallacy, as has been demonstrated. Both these fictions remain from the time when the goldsmith was the banker. The whole reserve system was instituted to cover up the goldsmith's deception, and is still in force to perpetuate the banker' control and furnish him an excuse for refusing loans. Both the gold standard and the reserve system have been stretched to the limit, and are ready for the waste-basket.

But until these fallacies, and the other features of unsoundness in our financial system are eliminated, the game we have just illustrated, and the evils we have shown to follow therefrom, will continue.

With the proposed remedy, however, the whole aspect of affairs would be changed. As we have shown how the other evils would disappear, so would this one also vanish. For we have seen that "call money" is the means by which this unfair condition is made possible. Under the proposed change in our financial system there would be no such thing as "call" money. There would be no lack of public confidence to guard against, and so the need of loaning money on "call" would disappear; the controlling handle would be removed from the wheel of fortune, and it would run free.

What little speculation still remained would be a real game of chance dependent upon judgment and the exigencies of trade and production.

A similar improvement would apply to trade in the other commercial centers—the wheat pit and the cotton exchange. These marts would thrive as centers for investment and trade, where people could transact legitimate business. The changes in the volume of the circulating medium would cease, and with them the resulting violent fluctuations which invite the gambler and enrich the sure-thing speculator. Instead of the present artificial fluctuations in price, we would have variations in real values only, due to legitimate changes in business enterprise. The movement of prices would result from differences in business ability, and from the laws of supply and demand, but the violent fluctuations arising out of the banker's cupidity, fear, lack of enterprise, or manipulation of call money, would no longer make of business a gambling game.

CHAPTER XIII

RURAL CREDITS

FROM time to time in the history of this country political parties have arisen, such as the greenback party and later the populist and silver parties, which advocated financial reform. The remedies invariably suggested inflation.

At one time the continuance of large greenback issues was suggested, at another, free coinage, as a means of increasing the money supply. Invariably these reforms resembled each other, in that they attacked the symptoms rather than the cause of the poor financial conditions. Owing to the latter fact the remedies proposed would not have removed the cause of our financial and industrial ills.

But, these political parties, during their time, were strongly supported by the farmers. Offhand it might be inferred that the financial interests of the farming element are opposed to those of the rest of the community, because farmers have always been ready to support parties proposing financial measures. As a matter of fact, however, this conclusion would be far from the truth.

The real reason for the support given these proposals by the farmers is due to the fact that the evils of our present financial system fall heaviest upon the agricultural interests. Those engaged in agricultural pursuits, being the more keenly conscious of the ills of the pres-

ent system, are the more eager for relief, and so more readily responsive to suggested reforms.

In truth, the interests of the farmers are identical with the interests of the rest of the community—excepting those of the parasites who profit by the farmers' present ills.

It is a truism to say that agriculture is the fundamental activity of the world, upon which all industries rest. Consequently it follows from this truism that any measure which increases the producing power of the farmer, is by that very fact a benefit to the community as a whole.

In other words, it is to everybody's interest that the farmer should be able to secure the funds necessary to carry on his business with an ease equal at least to that of any other producer. And yet equal financial facility is far from being the condition under our present system.

The difficulty experienced by the farmer in getting adequate credit facility is proverbial. And even under the Federal Reserve System no adequate provision was made for agricultural interests. This fact was practically admitted by the passage of the Farm Loan Act, following an ineffectual attempt of the Federal Reserve Board to serve the farmers of the country through the national banks.

It may be well to state that the attempt on the part of the Federal Reserve Board failed for two reasons. The first of these is that the member banks found it difficult to serve the interests of the farmer and their own interests at the same time.

The second reason is that private control puts a time

lock on the bank's credit which the farmer cannot work. The meaning and force of these causes will be explained in the following pages.

But the effect of the failure was the passing by the Federal Government of the Farm Loan Act, an act specifically intended to deal with the credit requirements of agriculture. This act has fallen short of its purpose, as will be shown presently, but irrespective of its success or failure, we may inquire as to the implication of this special act.

Is it not an acknowledgment that agriculture, upon which all other commercial activities depend, is practically outlawed under the present financial system? And does it not seem to imply that the farmer, like the Indian, is a ward of the government?

Singling the farmer out from the rest of the business world as this rural credit legislation does, it suggests that he is a kind of financial weakling, unable to take care of himself, and, therefore, a fit subject for special governmental care.

Let us see whether such an impression is in any way justified. Let us compare the manner in which the farmer has run his business—that of providing food, or taking care of the food requirements of the country—with the way the banker has run his business, the business of taking care of the credit requirements of the country.

From 1837 to 1907, as we learned, a disastrous financial panic occurred on an average of once every ten years, with several money stringencies in between the times of panic.

Since the banks have displaced government money by bank credit it is the banker's business to supply the nation's commerce and industry with an adequate amount of the medium of exchange, and the bankers are plainly at fault when this medium is not adequately supplied.

Consequently, this decennial breakdown of the financial system suggests a considerable degree of inefficiency on the part of those who have assumed the responsibility of supplying the medium of exchange.

A breakdown of the agricultural system in any way comparable with the oft-repeated collapse of the financial system would have meant dire famine throughout the land. Such a famine has not once occurred.

While the banker has repeatedly failed to supply us with a medium of exchange adequate to the needs of the business of the country, thereby bringing loss and misery, not only upon himself, but upon the entire nation, the farmer has meanwhile gone steadily on, supplying to the country, year after year, its requisite food supply.

Considering achievement, therefore, there is no justification for the assumption that the farmer is less capable financially than other producers. The fact that the government is obliged to establish a special institution to take care of his financial necessities is clearly not due to any fault of his.

After a consideration of the foregoing, are we not justified in placing a charge of inefficiency against the banker, rather than against the farmer, for the failure of the present financial system to supply proper credit facilities for agricultural enterprises? As we shall show, this assumption is entirely correct.

But for the present let us note how, through our government, we have treated these two different groups, the farmers and the bankers. Let us make a comparison of the help given by the nation to the banker with that given to the farmer.

After the bankers had made experiments at the nation's expense, going even to the extent of issuing clearing house certificates in open defiance of the laws of the land, the country came to their rescue and placed the credit of the United States back of their credit through the Federal Reserve System. If the bank now trades a little too much on its credit and finds that current funds are needed to conduct business safely and profitably, there is at hand an institution, supplied with practically an unlimited amount of government money which it will exchange, dollar for dollar, for the notes and drafts and other commercial paper that the banker has purchased.

But, although the Federal Reserve System furnished the banker with ideal facilities, the law did not require him to use any of his own time or to assume any responsibility in its establishment or operation. The only requirement was that he make an investment of six per cent of his capital and surplus, on which he was assured a six per cent cumulative dividend.

But note the difference in the case of the farmer. In order that he may take advantage of the Farm Loan Act, the farmer must get nine other farmers in the neighborhood to join with him, all of whom measure up to certain definite qualifications. These ten must then incorporate a "National Farm Loan Association," a banking

institution which they must officer and manage, although banking is entirely foreign to their business experience. They are then required to subscribe to the stock of this association five per cent of the aggregate sum the association wishes to borrow.

This subscription carries with it a stockholder's liability which cannot be evaded, as the holders are not permitted to sell their stock. When all this complicated business is done, the farmer may borrow from one hundred to ten thousand dollars on a mortgage payable in a definitely prescribed way in not less than five nor more than forty years, and the money borrowed may be used for only a few specified purposes and for none other.

These provisions are such that the farmer who needs money, unless to clear an existing mortgage, probably would have to go outside to borrow funds for the required subscription to the Farm Loan Association stock. If the farmer's condition and needs meet the rigid restrictions of the loan, he may borrow to pay for land, buildings and implements which constitute his plant; but no provision is made for working capital.

Now farming requires financing on terms similar to other manufacturing industries. Two prime factors enter into the building and operating of any manufacturing enterprise. First, there must be capital to pay for the site, construct the buildings, and supply the machinery of the plant. Secondly, there must be funds for operation. The second requirement is fully as important as the first, for many well-planned and completely equipped manufacturing enterprises have failed for the lack of adequate working capital.

Now the Farm Loan Act was doubtless an attempt to meet the farmer's financial necessities. Its principal object, however, as stated in the title of the act, seems to be—"to create standard forms of investment based on farm mortgages," giving only a minor place to the ostensible object, "to provide capital for agricultural development." In this way the interests of the farmer are made incidental only to those of the investor.

Therefore, as a remedy for the extremely unsatisfactory financial condition of the farmer, the Farm Loan Act is far from being successful. For while it attempts in a fashion to supply capital for the farm plant and equipment, it not only fails to supply working capital, but makes it increasingly difficult to obtain the necessary current credit after supplying funds for the plant and accessories.

At a signal of distress, the country came to the rescue of the banker with the Federal Reserve System, which supplied him with a completely equipped institution backed by the credit of the nation and ready to serve him without cost of time, money or responsibility.

But the plea of the farmer was answered by throwing him a bunch of red tape and a few dollars out of which he was supposed to fashion an institution which would supply his special needs. So many conditions were attached to the money, finally supplied, that few farmers could take advantage of the opportunity to secure it. Those who, after much labor, erected such an institution, found that it met but half their needs at best, and this need was not the portion of greater necessity to the majority of farmers, which was for working capital.

Suppose a limb of the human body suffered because an arterial stricture shut off its required supply of the life-giving fluid. Would surgeons attempt to cure the affected limb by amputating it and expecting it to live and prosper by setting up its own circulatory system? Yet this is in reality what the Farm Loan Act does, for our medium of exchange, whether it be gold, government paper, or bank credit, is the life-blood of the nation. Because of a stricture in the circulation of our medium of exchange, the Farm Loan Act severs the agricultural limb from the national body, and expects it to lead a separate existence.

And what is still worse, this Farm Loan Act does not even do what it sets out to do. In farming, as in every other industry, two financial elements are required for success. The Farm Loan Act attempts to provide for only one, and makes the securing of the other more difficult.

It requires the farmer to organize and operate Farm Loan Associations that he may secure a part of the first element of success—a plant—and this very act hinders him in securing the second element, working capital.

Our farmers have conquered the wilderness and have carried the light of civilization and the little red school house across a vast continent; they have fought and won battles for freedom in the past and have proved a great factor in the world struggle just ended. Therefore, to single them out of the community, as the Farm Loan Act does, and expect them to set up and put into successful operation a banking institution which creates a separate financial world, wherein they must live and prosper, is

adding insult to injury, and imposes on them an unwarranted task.

From the time the farmer puts the plow into the ground, to the time his crop reaches the market, he is beset by insect and animal pests and by weather conditions, labor, and transportation difficulties.

When his product finally does arrive at the market, he is met by the speculator. This Ishmaelite, aided and abetted by our financial system, takes a liberal and easy toll from what has been produced by hard physical toil and unremitting care.

The farmer who survives these natural and financial enemies must be a hardy individual, justly entitled to be considered the bone and sinew of the nation.

But, as if this were not enough, the Farm Loan Act, as we have seen, requires the farmer to provide his own credits. Supplying credit is clearly the banker's business; and, as if he had not enough burdens already, the farmer is required to take over the banker's work also.

The farmer should not be compelled to provide his own system of financing any more than the banker should be compelled to grow his own food.

Division of labor is requisite to civilization, and it is the farmer's function to supply food and raw material. The banker, in common with all other members of society, is dependent upon the farmer for food and clothing, just as all other elements of society are dependent upon the banker for the medium used in exchanging goods and services.

The banker's dependence upon the farmer is not so direct, and is, therefore, not so easily controlled, nor so

keenly felt, but it can be clearly seen, however, if one pictures a situation wherein the banker would be forced to produce that which the farmer might choose to refuse him.

Now then it is certain that just as it is the farmer's function to provide us with food and raw materials, so it is the banker's function to provide all with the medium of exchange. The failure of the banker to supply the farmer with proper credit facility on terms similar to those extended to the other producers, is due to inefficiency on the part of the banker and is no fault of the farmer. Yet the result of the flaw in our system has been to make the farmer a financial nuisance to the banker, and a subject for governmental care.

But in this phase of the general situation, as in all those we have already dealt with, the real cause of the trouble is neither with the banker nor the farmer.

It is in the fundamental fault of the system. It arises out of that defect in our present financial arrangement that is responsible for all other evils—the defect of private control, and its inability to endow bank credit with a full measure of public confidence.

To prove our case, let us compare the situation of a farmer with that of a manufacturer.

A shoe manufacturer, for instance, having the technical knowledge, the machinery and tools necessary and enough money to pay a month's rent in advance, can start a factory with assurance of success, because he is able to use the present financial system. In addition to his plant he needs leather and labor. To secure the leather, the manufacturer simply orders it and when it

arrives he "accepts" a draft for the price payable to the vendor within thirty to ninety days. This draft is called an "acceptance," which the leather dealer may discount at his bank for cash.

Our shoemaker next employs labor and begins to turn out shoes. If he has a reputation as a successful shoe manufacturer almost any commercial bank will provide the money (or most of it) to carry his payroll—for thirty days or more. During this period he gets goods ready for the market. Then he sells the shoes at a price that covers the cost of leather, labor, rent and profit and draws a draft on the purchaser, who writes "accepted" across the face of it and signs his name. This paper, the manufacturer turns into his bank, where it is discounted for cash. Out of the proceeds of this draft, the manufacturer pays the bank the money advanced for the payroll and the acceptance for the leather, besides taking care of the coming month's rent. Furthermore, he still retains a profit that he is not compelled to turn over to a speculator.

To start this manufacturing business, we grant that the shoemaker had a technical knowledge of shoe making, some equipment, enough money to pay a month's rent and the incidentals for sixty days. The bank, however, did the rest, and was glad to get the business.

Now the farmer is a manufacturer, just as surely as the shoemaker. He takes the raw material in the form of seeds and live stock, and through labor applied to the soil and the care of animals, he produces goods for the market. Provided he is equally capable in his line, and enjoys an equal reputation for success and honesty,

is it not clear that he should have the privilege of doing business in the same manner as the shoemaker? And in fact, his property, business stability, efficiency, and his record for meeting his obligations, are such as justly to entitle him to ask credit from the banker on the same terms as those upon which other lines of endeavor are financed.

At present, this privilege is denied him. As we now see, it is by no means his fault. Nor is it the fault of the banker. It is the fault of the banking system, which, owing to a lack of public confidence due to private control, is forced to set a time limit of thirty, sixty and ninety days for commercial credits.

Unlike other producers, the farmer is dependent upon nature, and cannot produce his goods within ninety days.

If the banker could put one hundred per cent confidence into his credit, and keep it there, no time limit for credit would be necessary nor would reserve requirements, which limit the amount of bank credit, then be necessary.

If after securing public confidence the banker were required to treat all applicants for loans alike, there would be no necessity for rural credit institutions, nor for a government financing corporation such as we had during the war and which has been reinstated recently. In that case everyone, farmers included, would be enabled to make such use of the medium of exchange as their business justified.

But until the people know that every dollar of credit issued by the bank is based on safe and ample security, they will not have complete confidence in bank credit.

And until this one hundred per cent confidence is attained, commercial banks will have to base their loans on "liquid" assets and will have to continue to limit their loans to thirty, sixty and ninety days. This limit of time will continue to make commercial banks useless, or almost so, to the farmer, the exporter, and to nearly all other business interests requiring a longer use of credit.

Securities now may be perfectly good, and yet may not be liquid. Of these the banker will say: "It is a good, but not a bankable, security."

Statistics show that the farmer's security is good. It is not bankable, however, because he must have money for longer than ninety days.

The banker, not being able to command sufficient public confidence, cannot safely issue his credit for a longer period.

Since the banker "issues" practically all of our medium of exchange, the farmer is through this defect, and through no fault of his own, outlawed by our present financial system.

As the farmer is an important member of society, and since the banker had to eliminate him to insure his own safety, Congress created a special institution supposedly for his benefit.

While, therefore, the Farm Loan Act would seem to be for the farmer's benefit and implies inefficiency on his part, in reality its purpose is to relieve the banker of a duty that is plainly his. It is in truth a relief measure for the banking interests and a token of the banker's inability, and not one to relieve the farmer nor is it due

to any inefficiency on his part. Let us see what the present situation leads to.

Thirty, sixty and ninety day money will not raise and harvest a crop or carry live stock during its period of growth. But it will enable a middle man to market harvested crops and matured stock.

So here we see our present system opposing the best interests of the community and the banker unconsciously standing in league with the despoiler.

The middle man knows how to use short time money and how to get it from the commercial banks, so he takes a slice from the profit which rightfully belongs to the farmer, and extracts additional tribute from the consumer, without contributing one fraction of a mill to the value of the product.

Our whole financial system is framed for the benefit of this go-between, while the farmer, upon whom the community depends, remains an economic outcast because of his inability to get inside the banker's time limit.

And there is yet a further effect of this set of circumstances, in that a second reason is furnished which will cause present conditions to continue to prevail under the existing financial system.

In the first place, the bank must maintain a bulkhead of liquid assets against a possible decrease in public confidence; and a twelve, eighteen, or twenty-four months' note signed by a farmer, who is unknown to the community, is not a liquid asset.

The second reason is that the banker makes a greater profit by dealing with the speculator than with the

farmer; and, since a bank is a private institution, so long as it is permitted to serve private interests without regard to public welfare, it will naturally seek the source of larger profits.

With regard to this, it is true, and happily so, that individual bankers are not now so generally seeking "extra profits" as in times past. Nevertheless, those who so desire can still align themselves with speculators in a combination which stands both farmer and consumer on their heads and shakes the money out of their pockets.

Now the only difference between the bank credit required by the farmer and that supplied to the merchant and speculator lies in the length of time for which it must run. The farmer requires longer credit than the banker is able to give him, under existing conditions. As we have seen, the proposed remedy, when in effect, will place a full hundred per cent of public confidence behind bank credit, and thereby remove all necessity for a time-limitation. In that case also the amount a bank could lend would be limited only by the amount of good security offered and not by a silly reserve requirement as at present. Farmers would then be on the same financial footing as merchants, and farm loan acts and the like could be consigned to the scrap pile.

As may well be imagined, the effects of such a change upon the welfare of the nation would be tremendous, so great, indeed, as to baffle our powers of description.

Suffice it, then, to point out one phase of the benefit to be gained, letting each individual see for himself what the total benefit would be.

As we have seen, owing to the present limitations on

bank credit, the farmer has become a financial nuisance to the banker, and a fit subject for governmental care. This condition is a detriment to agriculture. It has naturally caused people to depreciate the farming business. If, however, the agricultural interests enjoyed the same financial facilities as the manufacturer and speculator—that is, if a farmer could sign a note at five or six per cent per annum for a large share of what it cost him to plant and harvest his crop, or rear his stock, to be paid only when the goods produced are sent to market, then he would become a much more contented and respected citizen. This would be the cure for "urbanitis." A "back to the soil" movement would arise of itself, and the problem of congested centers of population would be solved.

CHAPTER XIV

THE FEDERAL RESERVE

THE creation of the Federal Reserve System marked a very great improvement in our financial and banking situation.

The fact is before it was instituted it could scarcely be said that we had a financial system. To be sure, we had banks the same as we have now, but we had no system, for each bank stood alone except in so far as banks co-operated by agreement among themselves or through the clearing house.

The effect of such a condition is best described by pointing to the fact that the country had a disastrous financial panic every ten years for the eighty years preceding 1907 with severe money stringencies in between the panics. Besides the panics and semi-panics money was always so tight every harvest time that the country heaved a great sigh of relief when the harvest was over. Any important event such as an election or a large business failure was liable to upset the whole credit structure and cause a panic.

The Federal Reserve Act has proved a great relief and it was slipped into Uncle Sam's Christmas stocking not a day too soon. It was approved on the twenty-third day of December, 1913, and turned out to be a valuable Christmas present. Subsequent events suggest that the motto on our coin, "In God we trust,"

was chosen advisedly, for an all-wise Providence must have directed the adoption of this act at this particular time.

Not long after its adoption came the shock of war, which would have thrown our shaky financial system to the ground, like a house of cards, had it not been for the support given it by the new law. That this support was provided just in time to avert a great calamity proves that our faith in Providence has not been misplaced.

Roughly stated, the main feature of this act is that it created a central bank of issue similar to that which most European countries have had for many years. That is it created a bank for the bankers, where banks belonging to the Federal Reserve System keep their reserves and where they may discount or sell the notes, etc., they take for loans. In exchange for such paper as the Federal Reserve will discount, it pays federal reserve notes or federal reserve bank notes.

The law provides for a 40% gold reserve behind federal reserve notes, but the federal reserve bank notes are issued against government obligations in about the same way national bank notes are issued. In brief, these are the features of the system.

The value of the act was felt by the Comptroller of the Currency, who expresses what is owed to the Federal Reserve System in his report for 1916. After speaking of the unprecedented commercial activities of the preceding twelve months, he goes on to say—

"In past years, under inadequate and unscientific banking and currency methods and systems, a great increase in business activity has almost invariably pro-

duced a money scarcity, has occasioned high interest rates, and sometimes has precipitated panics: but during the last eighteen months of unexampled prosperity we have enjoyed, throughout the length and breadth of the land, the lowest money rates the country has ever seen."

"No fair-minded man who has studied financial and business conditions for the past two or three years can fail to see how large a measure of these deeply gratifying results are to be credited to the operation of our Federal Reserve System."

This statement is a great tribute to the new system, but on closer inspection the words may also be seen to imply something else, something that we have been steadily maintaining all along.

To speak plainly, the Comptroller's words mean: first, that our privately administered financial system had always been an automatic brake on progress and prosperity; second, that the Federal Reserve System gave the private interests a certain amount of control, so that today a period of progress and prosperity is not necessarily followed by a financial panic.

Even private control is better than no control and, therefore, in so far as the Federal Reserve System has given the bankers a certain degree of control it has proved itself to be a benefit.

With its assistance, the crucial panic period of 1917 was weathered without a break-down in our financial system, such as had been a decennial occurrence since 1837. For this relief from panic we must thank the new system but our present state of business collapse indi-

cates that the sore spot has not yet been reached. The improvement made lies in the fact that our financiers have learned a lesson in the expensive school of experience in which they have been blindly working for so long. The lesson learned is the main principle that has been advocated by the writer, namely, that the only way of fixing the volume of the medium of exchange at the proper amount is to let the demands of business fix it; or in other words, by letting the productive activity of the community determine the amount of the medium of exchange in circulation. Let business control the medium by which it is carried on instead of having the medium control business.

The system attempts to achieve this object through the federal reserve notes, which are issued against commercial paper—that is, notes arising out of business transactions. As stated in the title of the act the object is to furnish an "elastic currency."

While the object sought was elasticity the act restricts the expansibility or elasticity of the currency by limiting the discount privilege to certain paper—"self-liquidating" securities—and also by the requirement of a 40% gold reserve against the federal reserve notes.

This latter restriction clearly demonstrates the tenacious hold which the fallacious gold standard possesses over the human mind. Even in a measure designed to alleviate the evils that follow from it, it cannot be shaken off.

However, this restriction is greatly modified by Section 11-C of the Federal Reserve Act, which gives the Federal Reserve Board power to suspend ALL RE-

SERVE REQUIREMENTS for thirty days and renew such suspension for fifteen-day periods without limit. This provision which follows permits an unlimited issue of federal reserve notes, "provided that it (the Board)

> shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified," and "provided further, that when the gold reserve held against federal reserve notes falls below 40 per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum per annum upon such deficiency until the reserve fall to 32½ per centum, and when said reserve falls below 32½ per centum, a tax at the rate increasingly of not less than 1½ per centum per annum upon each 2½ per centum or fraction thereof that such reserve falls below 32½ per centum. The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board."

The effect of this section is to make possible the issuing of federal reserve notes to an amount limited only by the demands of business or the action of the Federal Reserve Board.

The object of the provision is to do away with the limit fixed by gold on the elasticity of our medium of exchange—to unfetter it, so its volume may expand to meet the demands of growing and progressive industry.

This section, coupled with our present business condition, confirms all that we have been contending for, so let us examine it carefully.

The first point to note is that it gives the Federal Reserve Board the power to suspend ALL RESERVE REQUIREMENTS and such suspension may be continued indefinitely.

"Necessity is the Mother of Invention," and every one who has followed these pages must see clearly what was the necessity that caused this provision to be inserted in this law.

The provision so completely bears out our whole contention and the present unsatisfactory business conditions make it so clear that the object of the provision cannot be gained until the reform suggested herein is carried out that a few points must be reviewed.

Every expansion of business calls for a corresponding expansion in the medium of exchange. If for any reason the medium cannot or does not expand business hesitates and shakes confidence; then a slump follows. From the beginning of the commercial era the experience of trade the world over has been the same—slump has always followed prosperity—hard times have followed good. Every financial reform has sought to overcome this oft repeated phenomena but it continues to the present moment, as we are only too well aware. Two years ago industry was brisk, labor was active, business was good and times were prosperous; about a year ago credit was shut off or "froze up," business wavered for a few months, and then the slump started.

Some maintained it was due to "liquidation," others said it was a "buyers' strike," while everybody laid it to the "H. C. L." and now we are promised good times as soon as we return to "normalcy." But the trouble with

"normalcy" is that a condition of slump or hard times is just as much or a little more our normal condition than prosperity and good times.

It has been fully explained how this condition is brought about because credit is limited to a promise to pay a certain commodity, gold, which makes a reserve limit necessary. This folly and deception is exposed in the following chapter although it is fully explained in Chapter V and the method by which it may be overcome is given in Chapters VII and VIII.

The present slump makes it most certain that this provision in the Federal Reserve Act which was intended to overcome the phenomena of slump following prosperity has not accomplished its object.

A little reflection will show the reasons. We still have the false promise of gold redemption as a basis for credit and its use is privately controlled. Until these defects are removed the phenomena will continue.

This provision is a wise one and aimed in the right direction, for it is an attempt to overcome the limit fixed by the gold standard. It shows that part of the lesson has been learned. But while aimed in the right direction, it is not aimed at the real cause of the trouble —private control. However, it shows clearly that financial reform is tending in the direction we wish it to go and the suggestion in Chapter VIII, of thirty words to be inserted in the Federal Reserve Act, which will overcome all the trouble, is but one short step in advance.

This provision in the act had to fight against a strong national prejudice which had been handed down from the beginning of our government. The provision, in permit-

ting an unlimited paper currency, as it does, had to encounter a long-continued and deep-seated enmity against precisely this one thing—an unlimited paper currency.

We should also note that the Federal Reserve Act overcame another national prejudice, as deep-seated and as long-continued as that against an unlimited paper currency. That was the prejudice against a central bank exercising some measure of uniform control over its many, diverse and scattered branch banks—a prejudice which has existed ever since the downfall of the Second United States Bank.

This prejudice may not be overcome but it has been sidetracked by the Federal Reserve System. This was accomplished by side-stepping and the juggling of terms in this way. Since the country was opposed to a central bank, twelve regional districts, with a Federal Reserve Bank and a board of directors in each district, were created. Then all were put under the control of the Federal Reserve Board in Washington. In this way a uniform control is exercised over the different banks just as if they were branches of one central bank.

In effect, then, and in order to circumvent a popular prejudice, the act did not establish a central bank with a branch in each district, as in Europe, but instead established the branch banks, and then consolidated them under one supreme management. Except for this distinction, which is really no difference, the Federal Reserve System is a reproduction of the European central bank idea. It very closely approaches the German Reichsbank in structure, method of management, and operation.

To the Federal Reserve System, then, we owe the fact

that our country has been able to pass through a period of great stress without recurrence of the formerly inevitable phenomena of bank runs and financial panic. These evils the Federal Reserve System has, at least so far, checked, and to this extent it has been a benefit.

Tight money and panics, however, are only the symptoms of a deep-seated trouble, and the system cannot be rectified until the underlying flaw has been removed. This flaw has not been removed, for the Federal Reserve System has not broken the strangle-hold of our bankers upon the prosperity and business life of the community. So far from removing the private control of our bankers over our medium of exchange, the Federal Reserve System tends rather to strengthen it. This private control, the real trouble maker, like the mosquito which carries the yellow fever germ, is relatively insignificant in comparison with its bad effects, which no doubt explains why it has evaded detection so long and why it was left untouched by the Federal Reserve Act.

Instead of securing 100% confidence by public control of bank credit, the Federal Reserve System seeks to gain confidence for our medium of exchange by putting the nation's credit at the disposal of the banks. This arrangement has to a degree allayed the bad symptoms of bank-runs and panics.

The nation's credit is loaned to the bankers by providing a discount market for the paper the banker buys with his credit. That is, it established "shops" (the regional bank) where banks belonging to the system may exchange the notes they have taken from their customers for federal reserve notes, which are guaranteed by

the government. This arrangement has greatly strengthened the position of the banker and reduced the hazard of loss of public confidence. Through the regional banks all the discountable paper in a member bank's possession can be turned into government paper any time its depositors want money. Assuredly such an arrangement strengthens public confidence in the banks, for it practically gives to each member bank a master key to the national treasury.

Putting the nation's credit at the disposal of the bankers has, of course, increased their lending power and to that extent the system has improved the elasticity of our exchange medium.

That we have improved our financial system by establishing the Federal Reserve Bank cannot be denied for we have increased the two elements, safety and elasticity and on them depends the efficiency of any medium of exchange. But, would not these two vital elements, safety and elasticity, be enhanced still further by public control of bank credit?

If the people knew that every loan every bank made was based on security approved by themselves they would have one hundred percent confidence in bank credit. In that case all bank credit would be perfectly safe and any or all of it could be exchanged for federal reserve notes whenever desired.

Under public control the amount of bank credit would be limited only by the amount of good security offered and as equal facility would be enjoyed by all, our medium of exchange would then be one hundred percent elastic.

So public control, by giving perfect safety and per-

fect elasticity, would accomplish what the Federal Reserve Act tries to accomplish.

As long as bank loans are left to the unrestricted will of the bankers the little gain in safety and elasticity secured by means of the Federal Reserve Act are at altogether too great a cost in personal liberty and national efficiency.

To give up our American principles of liberty and equality for any degree of financial stability is too much like asking the wolf to accept the house dog's collar in order that he may be well fed.

A remedy that aims to improve our financial system at the cost of our principles may be suffered as a palliative, but only pending the operation necessary for a cure.

While admitting that it has greatly improved our financial system, the Federal Reserve Act does not reach the fundamental evil. On the contrary, it only tends to cover up the flaw, private control, by giving it the appearance of public control. The impression of public control is created through the federal reserve notes being printed by the government but they are issued only when and as called for by the banker.

Instead of breaking the hold of private interests on the commercial life of the nation we see that the amount of federal reserve notes in circulation depends entirely upon the amount of paper the private banks choose to discount. To insure justice and an equal opportunity for all and to promote efficiency and prosperity the circulating medium should be regulated entirely by the business activity of the whole community.

To the extent that the Federal Reserve supplies an elastic currency through privately owned and controlled banks it is good, but it serves only those interests which have access to these private banks. It does not, in its present form, nationalize our medium of exchange as it should and could be made to do, nor does it remove the stranglehold of private interests from the throat of industry.

The title of the Federal Reserve Act recites that the primary purpose of the act is "to furnish an elastic currency, to afford means of rediscounting commercial paper," etc. The only means by which the act furnishes an *elastic currency* are: First, by reducing the legal reserves required to be held by member banks, thus allowing them to issue a larger amount of bank credit on the reserve; and, second, by allowing the member banks to take private obligations (acceptances and commercial paper) purchased with their credit to the Federal Reserve Bank and exchange this private paper for government obligations in the form of federal reserve notes.

This crystallization of bank credit into government money adds greatly to the stability and value of bank credit and dignifies it by the name of *currency*. The added amount of bank credit put into circulation by the reduction of legal reserve requirements and the increased credit that banks are encouraged to issue through discounting private paper for federal reserve notes, constitutes the "elastic currency" furnished under the Act.

The accepted meaning of the term "currency" is government-issued paper money, and in this sense the federal reserve notes are "currency," since they are issued

by a Federal institution (the Federal Reserve Board) and they are obligations of the government. Yet the word "currency" is essentially misleading when applied to these notes. A careful examination of the *modus operandi* of their issuance shows that they are put into circulation only on the action of the banker and not at the will of the government. The government institution which issues them operates only when the banker turns the crank because they are issued only in exchange for paper which the banker has taken by making a loan of his credit.

The point is this, and it should be perfectly understood: federal reserve notes are called forth only in exchange for commercial paper purchased by the banker with bank credit. It is done in this way: Jones wants to borrow money. He goes to the bank where he is known and applies for a loan. If the bank's finance committee (our "money trust") passes the loan Jones puts up his note and securities and receives credit (bank credit) on his pass book for the amount borrowed. Now let us suppose Jones and others draw on the bank to the extent that the banker needs money. In that case the banker simply takes Jones' note to a Federal Reserve regional bank and exchanges it for its discount value in federal reserve notes. This privilege of trading private paper for government money is extended only to "member banks." Since this currency is issued only in exchange for paper presented by these banks, we have in effect turned the United States mint over to the bankers.

How completely the mint has been turned over to the banking interests may be judged by the percentage which

these notes and national bank notes bear to all the currency in circulation.

Before the days of the Federal Reserve we had in circulation, besides the national bank notes, greenbacks and gold and silver certificates. The bank notes, as their name implies, were and are "bank money" issued by the national banks and we have seen that the federal reserve notes are also bank money, but the others were and occasionally are now issued by the government and may be referred to as the "people's money."

Now in order to ascertain to what extent the banks have encroached on this most important function of issuing money, that is, to what extent the bankers have taken charge of our mint—just take note of the money that comes into your possession and see what percentage of the whole is made up of gold coin, gold and silver certificates or greenbacks of large denomination and what percentage consists of national bank notes, federal reserve notes or federal reserve bank notes. If silver coin and the lesser coins are excluded from this calculation, for the reason that there are no bank issues to take their place in making change, you will find that the "people's money" is practically unrepresented. "Bank money" has so nearly displaced the use of government money that gold coin, gold and silver certificates and greenbacks of large denominations are now curiosities.

No question is raised as to the safety of these federal reserve notes. They are good, safe money, for not only do they have private credit for their full face value behind them, but they are government obligations and are, therefore, as safe as government bonds.

The real effect of the Federal Reserve System is to strengthen the position of the bankers. It does not in the least tend to remove the vital defect in our financial system. Federal reserve notes are a crystallization of bank credit, in which the security of the government is added to the security of the banks. These notes are a safe medium; but the bankers are in control of their issuance. The Federal Reserve Banks do not deal with the people. They are bankers' banks only. The privilege of turning credit into our national currency is, therefore, still in the hands of the few private citizens who control the banks.

The Constitution reserves to the Federal Government the right to coin money. In order that all may share equally so important a privilege, gold is given the right of FREE coinage. Any one possessing gold bullion may take it to the United States mint and receive its full value in coined money. The gold coinage law is general in application, and confers the right equally upon all. If a law attempted to say that only a few, or only a certain class, had this particular privilege, it would be condemned as class legislation and as being undemocratic, for under our declared principles, all men should be equal before the law.

Since bank credit has almost entirely replaced gold as our medium of exchange, it should be issued under the same conditions as apply to the coinage of gold. The freedom from special privilege, which accompanies the coinage of gold, should be applied also to the minting of credit. Value, in all its concrete forms, is the real security behind bank credit and all who bring value to the

bank should, therefore, be privileged to receive the same percentage of the medium of exchange thereon.

But how completely this principle is ignored! In the federal reserve notes we have a crystallized form of bank credit, constituting a major part of our circulating medium. Yet these notes are issued entirely at the will and discretion of various groups of private citizens, the finance committees of banks, wholly without regard to individual rights, constitutional provisions, or to the democratic principle that government must be administered impartially.

What an outcry would be raised were the government to mint gold bullion into coin for a certain class only. But compare the number of persons who have gold bullion to exchange for coin at the public mint with the number who go to the private mint, to wit, the bank, to have their securities coined into bank credit, through a loan which may subsequently be coined into federal reserve notes by the banker.

In this private mint, which is far more important than the public mint, privilege exists to the highest degree. And besides this fact the arbiters of our fate are responsible to no one, not even to their own consciences. For in all probability they do not themselves realize the far-reaching effects of the autocratic power they wield.

The effect of the Federal Reserve Act is that it intensifies the grip which the bankers have upon our whole industrial system. By placing the strength of the national government behind bank credit, through the issue of federal reserve notes, without taking out of the bankers' hands the control over the issuing of that credit,

the Federal Reserve Act confers upon our bankers a privilege that is vastly more important than the right to the free coinage of gold. Consciously or unconsciously, it undermines the principle upon which our government was founded, the principle of equality before the law. Unless this principle is upheld, no democracy can possibly endure.

At once the matter becomes not merely a financial problem, nor a mere question of banking or business methods, it reaches to the very bedrock of our social institutions, and its importance is commensurate with its depth.

The Federal Reserve System, then, is at best no cure, it is a sedative, nothing more. It has soothed the banker's fears, and injected some confidence into the public mind, thus enabling us to pass through a very trying period in our history. But like all sedatives, it has a bad result. Its narcotic effect renders more difficult the location of the cause of our social ills—for it lulls us into the belief that the disease has been cured.

Because our usual decennial panic did not occur, and our chronic state of money stringency has been somewhat relieved, the belief is common that our financial evils have been cured; while the truth is that the cause of these unfavorable financial manifestations, and of most of our political, industrial and social ills, remains untouched.

And, what is even worse, the system attempts to cure our financial ills by increasing the real defect in our social system. Under this act the private control of our medium of exchange is given a firmer grasp upon the

nation. The Act has rendered the money power more dangerous to our personal liberty, and gives it greater opportunity to encroach upon our national democracy.

While the Federal Reserve Act has fallen far short of its purpose, it has performed a service and it has within itself a latent power for good. For although the act is not a cure in its present form, it furnishes a most convenient and readily adaptable instrument through which a real cure may be administered.

The act should be amended by striking from the title the word "Reserve," making it read, "The Federal Bank Act," then the body of the act should be amended to conform to that title. With the addition of a few words to put into effect the suggestions made in Chapter VIII, the flaw not only in our financial system, but in our social system, would be removed. A simple change indeed and one that could be easily made to the benefit of all and with no disturbance to business.

CHAPTER XV

THE CONSERVATIVE BANKER AND HIS RESERVE JOKE

THE banker is an extremely conservative person. He clings closely to the status quo and is fearful of all changes, regardless of the reasons which may prompt them. This attitude on his part is exactly what might be expected, for the banker enjoys such a secure and powerful position under existing conditions that any change seems likely to him to result in a lessening of his power, consequently he will oppose all changes on principle.

The banking interests strenuously opposed the adoption of the Federal Reserve Act, just as they have opposed many other pieces of constructive legislation. Opposition to change is the natural attitude of all bankers, but in the particular case of the Federal Reserve Act, this opposition was due not only to a general aversity on the part of the banker to any change, but also to another reason, a reason far stronger, and one which resulted in the bitter and united opposition of practically all the bankers in the country.

This reason was the original proposal to make the Federal Reserve Bank a people's bank, where borrowers could go directly for credit when private banks refused to accommodate them. The origin of this suggestion lay in the startling revelations of what was known as the

Pujo committee, which made a congressional investigation of the "money trust."

The testimony given before this committee disclosed the vast power wielded by a few rich men. It also showed up the black hand financial methods used by what we commonly call "Wall Street." Together the disclosures shocked the country. The result was a suggestion to establish a Federal Bank open to the use of the people directly.

But the mere suggestion caused such a cry of fear and such a frantic prediction of calamity from the bankers that it sent a cold chill down the spine of every business man.

One can well imagine the light in which the bankers regarded such a proposal. The whole subject of finance had always been shrouded in such a veil of mystery and the system had permitted the bankers to command homage and compel tribute from all for so long a time, that the granting or denial of credit had come to be looked upon by them as a vested right. Naturally any suggestion which had as its object the curtailment of this right would meet with strong opposition. To permit the people to use their own credit without the permission of the bankers and without paying tribute to them seemed to them to be an invasion of their rights. The idea of a people's bank for this reason, aroused them and the result of their opposition is interesting.

Natural history informs us that the octopus, sometimes referred to as the devil fish, has in its anatomy an ink sack from which it can, when attacked, emit a black fluid that will confound an enemy and cover its escape.

This characteristic seems to be common to the species, whether of the order "dibranchiate" or "financial." For by their clamorous opposition to the proposition of a people's bank, the banking interests succeeded in having the act recast. And it was cleverly recast, too, by the adroit hand of Wall Street, so that in its present form the people's bank idea was entirely wiped out, and every provision was turned to the banker's benefit.

And like the octopus, those who had it recast were clever to cover the effect of their operations with an impenetrable haze of financial fiction. The effect of the act in its new and present form was and still is generally misunderstood. Not only is this true of the average laymen, but also of many of the bankers. For, after the act had been changed so that the last vestige of a people's bank was removed, the opposition to it among the bankers remained. In fact their opposition was so strong that only the great impetus of popular pressure for some kind of relief, backed by the firm will of a deluded President, forced the adoption of this law, emasculated as it was.

The opposition of the great majority of the bankers, inspired by their natural conservativeness, was no doubt genuine. But when the features of this act are really understood, one cannot believe that the apparent opposition of the big interests was ever intended as anything more than a counter-irritant, with the object of making the people adopt the law.

Few laymen, and not even our law makers have given sufficient heed to the ultimate effect of this act. Those who uphold it do not see that under its veneer

of public good it gives the big financial interests a firmer grip than ever upon the business life of the nation. They have not noted that the act has put into the hands of these interests full control of the circulating medium. And so they fail to realize that the real effect of the Federal Reserve Act has been to give control of the medium, which is necessary to every industry and to every person, so completely into the keeping of a few that their power over the nation industrially, socially, and politically is practically complete. No political ruler ever wielded such an autocratic power.

This charge is a severe arraignment of a law popularly supposed to free the people from the strangle-hold of the money power. Facts and logic, however, make this charge. It is the only conclusion possible when the situation is understood. No other conclusion is tenable as can be seen from the exposition of the true nature of the act, given in the last chapter. We saw in Chapter XI that a former Secretary of the Treasury considered it necessary to deceive the people in order to cover the weakness of our financial system. The super financiers who shaped the Federal Reserve Act into its present form followed this suggestion most effectively and with surprising results.

The main points in the law have been explained. No object could be gained by following its intricate details and it would be unwise to attempt to do so here. The explanation of one means by which the act has been made to serve the banking interests will be apparent and will suffice. This is the way in which the greenback, at one time a very much despised and a very much opposed

type of national currency, has become highly appreciated by and very lucrative for the banker.

The greenback, United States note, or legal tender note was an unsecured promise to pay, first issued during the Civil War. It certainly was an ugly duckling though it afforded a great refuge during the stress of those times. By giving these notes full legal tender power, the government gave them all the force that a government can put behind an unsecured paper currency. However, for nearly twenty years, starting with their first appearance, an unrelenting attack both as to the validity and value of these notes was led by the banking interests. At one time these attacks drove their value down to less than forty cents on the dollar. The strife continued until the bankers finally had the matter arranged to their satisfaction. Greenbacks became available for reserve. They were "lawful money."

By means of the Federal Reserve Act, the banker succeeded in turning this "people's money," as the greenback was called by its advocates, into a most valuable "banker's money," and the way in which this feat was accomplished was as follows:

The Federal Reserve Act provides that the reserve of 35%, which all Federal Reserve Banks must hold against deposits, can be held in either gold or "lawful money." Greenbacks are lawful money. By means of this simple arrangement a miracle was wrought. Through this arrangement, which permits Federal Reserve Banks to carry their reserve against deposits in greenbacks, this despised paper currency became as valuable as gold.

To judge the effect of this miracle let us take, as an

example, a little jim crow bank in a country village, with a capital of $25,000 distributed as follows: $10,000 invested in building and fixtures; $1,500 in gold invested in Federal Reserve Bank stock, purchased under compulsion, on which the bank receives 6% cumulative dividends; and $13,150, in other securities. The bank has then left out of its capital $350, let us say this is in greenbacks.

The bank has no deposits as yet, but as it is compelled by law to maintain a reserve equal to 7% of its demand deposits and 3% of its time deposits with the Federal Reserve Bank of its district, it prepares for business by sending the $350 in greenbacks to the Federal Reserve Bank as a deposit. That leaves the till of our little bank as clean as old Mother Hubbard's cupboard; but the customer is not going to fare as poorly as the dog did, even if the till is bare and the customer happens to be a borrower.

It is easy to see how a bank with no money on hand can accommodate a depositor, but just how is this bank going to satisfy the borrower out of an empty till?

This feat is easy when you know how. Listen! Here comes the borrower with that humility and deference with which the borrower always approaches the banker and, by means of an eloquent appeal in which he tells the banker just how he is going to use the money, he finally succeeds in breaking through the million dollars' worth of dignity with which the banker surrounds his empty till. So he secures a loan of $1,000 for 90 days. The banker takes the borrower's note and securities and hands him in exchange a pass book with the date and

$1,000 written on the credit side. For the purpose of turning that daub of ink into money, he very graciously gives him a check book.

It usually thrills one with a sense of importance to be handed a nice new check book by the banker.

The borrower now has one thousand dollars' worth of the medium of exchange, bank credit, with which to do business, and the banker has one thousand dollars in personal credit, a note, at, say, eight per cent interest backed by good security. The question now arises, how are the checks which the borrower will draw going to be paid? The bank till being empty, one naturally wonders where the money is to come from. At first sight this seems to be rather a complicated problem, but when one understands the tricks of banking it becomes very simple.

Without loss of time the banker takes that $1,000 note to the Federal Reserve and discounts it at 6%. He draws out only $350 in federal reserve notes, thereby increasing his deposit of $350 already made with the greenbacks by $650, which gives him a credit of $1,000 as a reserve. So he goes merrily on receiving deposits and making loans.

Deposits of cash will probably equal or exceed withdrawals, so the $350 in federal reserve notes which he has taken out of the $1,000 note will give the banker ample cash funds for paying checks.

Let us follow this operation in frenzied finance and figure the yearly profit made possible for the banker through the proper use of a few greenbacks which his predecessor so despised.

On the note discounted, the banker profits by the difference between the 8% the note bears and the 6% for which it was discounted, or 2% on $1,000 which for one year would be $20. As this bank is required to carry a deposit in the Federal Reserve Bank equal to only 7% of its own deposits, and as it now has deposited there $1,000 it can carry deposits up to $14,285.71, for $1,000 is 7% of that amount. It can, therefore, create this amount of deposits by making $13,285.71 additional loans on which it will collect 8% or $1,062.85, which added to the $20.00 made on the note for $1,000 which is kept discounted makes $1,082.85 in all.

This income on each $1,000 of deposit with the Federal Reserve is not so bad a piece of business when one considers that the bank has not one cent invested. Its whole capital stock was put into income property or securities except the $350 in greenbacks, which were traded for federal reserve notes by discounting a private note. These notes are held by our little bank as CASH while the $350 in greenbacks are held by the Federal Reserve Bank as RESERVE. From the standpoint of "good banking" this arrangement has two advantages. It helps overcome the limit set by the gold standard and at the same time is not unprofitable to the banks, but from the standpoint of common sense to hold one piece of paper as reserve against another piece of paper when both pieces of paper are guaranteed by the same government look like a joke.

The foregoing income is obtained by figuring that all the deposits made with this bank are demand deposits,

against which it must hold a seven per cent reserve. A reserve of but 3% is required to be held against time deposits, and, consequently, were all deposits time deposits, the bank would be able to lend over twice as much of its credit. But without stopping to figure how much could be made on time deposits, let us see what could be earned by all the banks on all the greenbacks issued.

This problem of course is a hypothetical one, for all the greenbacks outstanding are not held as reserves by the Federal Reserve banks, and the problem assumes that they are. It is, however, not unreasonable to suppose that they could be so held, and, therefore, the problem is of interest in that it exposes the fallacy of the reserve system and shows a possible situation under the Federal Reserve Act.

The reserve requirements of banks, which are members of the Federal Reserve System, varies according to the location of the bank. Banks in central reserve cities are required to carry with the Reserve bank a credit of not less than 13% against their demand deposits, reserve city banks must have a balance of not less than 10%, other banks get off with 7%, while all are required to carry only 3% against time deposits. Let us take the average of reserve against demand deposits as 10%, and consider all the member banks as constituting one bank.

Then for every $10,000 of demand deposits carried this big bank would be required to have a credit balance with the Federal Reserve of $1,000 or 10%. This balance may be created by depositing money or discountable paper, but the Federal Reserve must hold a reserve of

35% against these deposits in either gold or "lawful money."

To comply with the law then the Federal Reserve holds, we will say, in greenbacks, for they are lawful money, $350 against every $1,000 deposited with it by the member banks. Since every $350 in greenbacks satisfies the reserve requirement for credit with the Federal Reserve then every $350 worth of greenbacks permits the member bank to carry $10,000 in deposits.

Now let us see how much bank credit can be issued in the form of loans by the member banks through using the full issue of greenbacks as the only reserve.

There are outstanding $346,681,000 in greenbacks and as the banks can issue ten thousand dollars of bank credit for every $350 held in the Federal Reserve, divide the $346,681,000 by 350 and multiply by 10,000. It gives a little less than ten billion dollars as the amount of bank credit which can be issued against legal tender notes, the despised greenback as the sole reserve.

If you can now get hold of one of these precious greenbacks, you will see that they are not redeemable in gold or anything else and the government will not even accept them for customs duties.

It is safe to say that not one person in a million knows or cares whether there is a gold reserve behind them or not.

Their value rests entirely on the belief that they will be accepted from us at the same value at which we accepted them. That is their sole value is CONFIDENCE.

The banker by putting something over three hundred

million dollar's worth of this form of confidence through the magic process of the Federal Reserve mill makes these pieces of paper carry ten billion dollars' worth of his credit, which is also confidence.

In this arrangement we have conclusive proof of the fact that our development has outgrown the gold reserve system for by this use of greenbacks as reserve the gold reserve idea is discarded. It also proves the correctness of our whole contention.

If ten billion dollars' worth of bank credit can be issued with nothing back of it but CONFIDENCE why not thirty or fifty or for that matter a hundred billion dollars' worth?

The point is to be sure of the confidence. As long as that is safe there is no limit.

By making the people know that every loan that every bank makes is perfectly safe the maximum of confidence would be secured and, consequently, our medium of exchange would be perfected.

This use of greenbacks as reserve is a powerful argument in favor of the suggestion made in this book for the reform suggested certainly would secure the maximum of confidence.

Instead of having ten billion of our medium of exchange based on green paper and the rest on "gilt" paper and then allowing private interests to dictate its use, why not have it all based on the solid rock of sure public confidence and permit everybody to use it on equal terms? Is there any reason?

Again, since all financial reform has always tended toward and striven to reach the goal of complete public

confidence why not put into effect a reform which will reach it and which will always hold it?

The fact that using the greenbacks as reserve is profitable to the banker is no argument either in favor of or against that arrangement so no criticism is intended by showing it. The only object is to complete the argument that the people's money has been made a profitable banker's money.

We have seen that on $350 of greenbacks held as reserve the banker can collect as interest on every $10,000 of his credit issued an average of say 7% or on the ten billion dollars' worth about seven hundred million dollars per year. We have also noted that the banker has nothing invested. When one considers that this income is made entirely out of the people's laws and the people's confidence, without any investment whatsoever on the part of the banker, the Wallingford stories seem not only probable but quite tame.

If the foregoing seems to be an exaggerated picture of existing conditions let us pursue the story and then prove up by a few figures taken from government documents.

The Federal Reserve banks are supposed to hold a reserve of 40% in gold against federal reserve notes in actual circulation. The amount of gold held December 1st, 1919, was $1,148,724,000 against which was outstanding $3,059,652,000 in federal reserve notes. This apparently is a gold reserve of 38% and only 2% below what the law requires. Besides this issue against gold reserve the Federal Reserve banks can issue federal reserve BANK notes to the full value of all govern-

ment bonds bearing the circulation privilege which they have with the United States Treasurer, and small bills against United States certificates of indebtedness, as authorized by the act of April 23rd, 1918.

Besides all this paper secured by paper there are the national bank notes secured by government bonds or an issue in December, 1919, of a little over 990 million dollars secured practically by paper only. Adding this amount to $3,059,652,000 of federal reserve notes gives a little over four billion dollars of paper money and practically the only gold held for its redemption is the $1,148,000,000 in the Federal Reserve or about 28%.

All this paper is spoken of as our national currency but altogether it constitutes but a small portion of our real currency or medium of exchange.

There are, in round numbers, 30,000 banks, state and national, doing business in this country. The deposits in these banks amount to about 33 billion dollars. If our financial system is really on a gold basis all these deposits are payable in gold. So we have a little over one billion of gold with which to redeem 33 billion of bank credit plus 4 billion of paper money, or, 37 billion of the medium of exchange. By dividing the $1,148,000,000 by the 37 billion it shows we have a reserve of about 3% of gold supporting our circulating medium.

That is, for every $100 of paper money and bank credit, which practically makes up our entire medium of exchange, there is $3 in gold. But you say the Comptroller's report shows there are about three billion dollars of gold in the United States although but $1,148,000,000 is on deposit with the Federal Reserve.

Yes, and there are also 25 billions of government bonds outstanding besides billions upon billions of private bonds, notes and accounts, all payable in gold. The amount of these debts payable in gold cannot be known but it is safe to say they amount so far into the billions that the percentage of gold to bills payable in gold in the United States would not exceed 1% or $1.00 on the $100. This is a rich country and holds about one-half the world's supply of gold. If we could figure out the percentage of gold to bills payable for all the countries which have based their system of exchange on the gold standard we would require a microscope to find the answer. It would probably not exceed fifty cents on the hundred dollars.

If an ordinary mortal should promise to pay us $100, when we knew he possessed but fifty cents and we knew full well that he could not possibly get any more we would look upon him with great distrust, even with disgust; but when the same promise under the same conditions comes from the banker we accept it.

Most of us can imagine, or have seen, a group of little girls "playing lady." With an old skirt of their mother's, or of their big sister's, they pretend that they are grownups, and that a corner in the attic is their home. One makes believe that she is Mrs. So and So, and another is Mrs. Somebody Else who comes to call. The whole point of the game is to "make-believe."

When we can escape from the magic spell of gold and cast off the fear of all things financial, the force of the story here presented will be readily recognized. The provision of the Federal Reserve Act which permits

the reserve against a promise to pay to be carried in a promise to pay makes a farce out of the gold standard and the whole reserve system is shown to be a game of "make-believe" and becomes a joke.

If the gold reserve idea, false as it is seen to be, were necessary to a proper working of our exchange system, it would be both unwise and unpatriotic to attack it, for naught but harm could result. The true condition, however, is the exact opposite for it is not at all necessary and besides it is robbing the whole nation of liberty and equality as well as prosperity and happiness.

This false promise to redeem in gold has but one result. It continues the strangle-hold of private interests upon our national life by bolstering up private control over the medium of exchange. It is a smoke screen which hides the truth that our financial system is nothing but a system of bookkeeping. The bank is a clearing house for credits, nothing else, and it will be a much more useful institution when the truth is recognized and the suggested reform is put into effect.

CHAPTER XVI

FOREIGN EXCHANGE

THE problem of foreign exchange exhibits a phase of finance that has of late been vividly called to the attention of the public. The variation in the value of foreign money as measured in dollars decides the course of foreign exchange. The question on this subject is, what causes this variation?

It is a question that is little understood even by those who handle exchange. Obviously, then, it is understood still less by the general public. As a consequence, a number of different explanations for this variation in the course of foreign exchange have been given. Let us examine the chief explanations and see whether they are correct.

Most bankers in trying to explain the course of foreign exchange, will assign as the main reason, if not the entire reason for the price of exchange, the difference in the gold reserve held by the various countries. The banker, who is accustomed to deal in foreign exchange, ought to know more about the subject than others who deal in exchange only infrequently or never. To determine whether or not the banker's explanation is correct let us examine the relationship existing between gold reserve and the price of exchange.

It has already been seen that in the United States, the richest country in the world, there exists about thirty-

three billions of bank deposits and four billions of paper money resting on a little over one billion of gold held as reserve or something less than three per cent. European countries are not advertising the amount of their gold reserve just now, so there is no authentic information at hand on the subject. It will be seen that the suggestion is so ridiculous, however, that we do not need exact information in order to show the fallacy of connecting the price of foreign exchange with the gold reserve.

Let us suppose that England, for instance, has no gold at all. In the United States each dollar has about three cents in gold behind it. The par value of an English pound in our money is $4.86. Multiplying this by .03 gives about fourteen and one-half cents as the worth of gold behind the equivalent of a pound in our money. Since we have assumed that there is no gold behind the pound in England it is worth as much less per gold reserve as there is less gold behind it than behind its equivalent. Since there is 14½ cts. worth of gold behind $4.86 of our money the pound is only worth that much less than its par value, so it is worth, then, $4.86 minus 14½ cts. or $4.71½. If the gold reserve sets the value of a nation's medium of exchange and we allow the maximum value behind one and the minimum behind the other, the difference should certainly be a conservative estimate of the ratio of value.

Since the pound sterling is quoted at the present writing at $3.56, and has been less, and according to the difference in gold reserve it should be worth $4.71½, there is a difference of $4.71½ minus, say, $3.56 or

\$1.15½ unaccounted for by gold reserve. It is plain there must be some other reason than gold reserve for this difference of \$1.15½ in exchange value. In order to locate the cause of this difference of \$1.15½ we must determine what other value is behind the dollar and compare that value with the value behind the pound.

On examination we find that the English monetary system is quite similar to our own. The English law requires that all Bank of England notes must rest on a reserve of gold or government obligations. These Bank of England notes constitute the paper money used throughout Great Britain the same as federal reserve notes, national bank notes and greenbacks constitute the paper money used in this country. Our paper money rests on practically the same kind of a basis as the Bank of England notes, that is gold reserve and government obligations. So the only difference in value would be the difference in gold reserve and the value of the different government obligations.

The gold reserve is a farce in both instances and as we have seen, accounts for but 14½ cts. on the value of the pound, under the most favorable circumstances, so it may be ignored in the search for real sustaining value.

On examination we find that British government obligations are more nearly worth par in Great Britain than American government obligations are in the United States. The value behind British paper money then is practically the same as the value behind our own.

As in the United States, so in Great Britain, bank credit constitutes the bulk of the medium of exchange. It is issued in both countries in practically the same

way, on notes and mortgages, and, therefore, the values behind it are as good in one country as in the other. The difference of $1.15½ in the exchange value of the pound cannot, therefore, be found in the sustaining value behind either the paper money or the bank credit.

John Bull's note is secured in the same way as Uncle Sam's. The fact that John's note is at a discount when measured in Sam's money cannot, therefore, be explained upon the basis of a difference in security.

In this case, then, it is plain that the gold reserve assigned by the banker as a reason for the price of exchange is erroneous but as there is no difference in other sustaining values the real reason has not been found. Let us now examine, for instance, the exchange value of the money of the other two large commercial countries of Europe, the franc and the mark.

Both the French and the German monetary systems have progressed beyond the folly of gold reserve. The paper money of both France and Germany is issued in the first instance through the Bank of France and in the second through the Reichsbank on the assets of the bank as security. In both instances it is issued in practically the same way that bank credit is issued in England and in this country.

The only difference between the paper money of these two countries and the bank credit of our own is in its form. When a French or German business man goes to the bank and puts up his note and securities for a loan he comes away with a handful of paper money. In this country the loan he receives from the bank is represented by a daub of ink in a bank book.

Practically the only difference is in the form of the banker's promise to pay. In those countries a banker hands out his I. O. U. in the form of a bank note and here in the form of an entry in the customer's pass book. If the banker here would hand us national bank notes and we would use them instead of his giving us credit on the bank's book, for us to transfer by means of a check, the system would be almost identical with that of those continental European countries.

Since the system of issuing the media of exchange in all three countries, though outwardly somewhat different, are really almost identical in principle, there cannot be much difference in real value between the media of exchange unless there is a difference in the security behind the bank loans. On examination, we find the securities which are put up for bank loans are substantially the same in form and effect and are practically equal in value, so the promises to pay issued by the different banks should be the same in value. But today we find the franc selling at about fifteen to the dollar, while the par ratio is a little over five to the dollar; and we find the mark, with a par value of 23.82 cents, selling for the time being at one and one-half cents. This discrepancy clearly indicates, then, that the difference in the price of exchange cannot be attributed to a difference in system or to a difference in the value of the security behind the media of exchange of the different countries.

Since the banker's explanation of difference in gold reserve does not explain and we find no difference in other value, let us turn to another attempted explana-

tion. There is one which bases the difference in the price of exchange upon the volume of the medium in circulation in the various countries, or rather, upon the ratio of inflation.

The first country called to mind in this connection is Russia. Here inflation has been carried to such an extreme that the Russian rouble is almost valueless at home. Naturally, then, it is even less valuable in foreign exchange; and in fact it has so little value that it is no longer quoted.

This would seem to demonstrate the truth of this second reason given for the price of exchange. However, even in the case of the rouble, it is not the only reason; the value of credit money depends upon the stability of the government and the institution issuing that money. Russia at present has no government worthy of the name. The effect is the same as the effect of over-inflation; it reduces the price of the rouble in foreign exchange. To over-inflation, then, it is not permissible to assign the whole of the abnormal lack of value of Russian exchange.

It would seem, therefore, that the ratio of inflation, while quite possibly one of the factors affecting the price of exchange, is by no means the only factor. This conclusion is brought out still more forcefully in the case of exchange on England, France, and Germany. For in these countries their medium of exchange is inflated little if any more than ours is in this country.

In the leading European countries the rise in the cost of living since 1914 has been no higher than it has been in this country. In 1914, however, exchange

between these countries and the United States was at par or practically so. And to account for the present value of the franc, for instance, on the inflation theory, the cost of living in France would have to be relatively three times as high as it is in this country, because the franc is about one-third par.

Now it is true that, on account of the adverse rate of exchange with the United States, goods imported from this country to France are three times as high as normally; for the francs with which they are bought are selling at one-third their normal exchange rate, so in figuring the cost of living, these goods must be left out of the calculation.

At present it costs the average American family of of three, we will say, $100 a month to live in this country. At par this sum would be equal to 500 francs; a sum probably greater than that which the average French family spends for living. If inflation, however, made the franc worth what the exchange rate quotes, then it would cost the average French family 1500 francs per month.

The same reasoning applies, only with greater emphasis, in the case of Germany. In order to account for the German exchange rate on the ground of inflation, the cost of living there would have to be over fifteen times what it was in 1914. Taking the mark at its present exchange value, a family of three would have to spend at present about 7,000 marks monthly for living on the same scale as the average American family of the same size.

While the difference in inflation, then, is to some

extent a factor in determining the present abnormal rate of exchange, it is at most only a minor factor. For the fact is that, exclusive of goods which must be imported, the cost of living in England, France, and Germany is relatively little if any higher than it is here, if we figure their money at par. Or, in other words, English money, French money, and German money are worth in those countries as much as they ever were and as much as our money is here.

What then is the real cause for the difference in exchange rates? We have seen that the reason advanced by the banker, the difference in gold behind the money of each country, is not correct and that there is practically no difference in the security behind each. We have also noted another reason, the relative inflation, and find it to be inadequate to explain the present price of exchange. What then is the real explanation?

There are two factors that account almost entirely for the present state of foreign exchange. The first of these is the balance of trade, and the second the position of the foreign exchange speculator.

Trade can be compared to a clearing house operation. If I ship you one hundred barrels of flour worth ten dollars a barrel and you ship me ten barrels of dye stuff worth one hundred dollars a barrel, the transaction clears itself.

It may happen, however, that you buy the flour from me, but ship me in return goods worth only a part of its value. Two possibilities arise at this point. Either you will pay me the balance in money, or I will trust you to pay me later.

Perhaps you are unable to pay the balance in money immediately. If I have perfect confidence that you will pay me in goods or in money at a later date, then it will be to my advantage as well as to yours to let you have the flour. For to do so will stimulate trade. On the other hand, to refuse to let you have the flour will harm me as well as you. For the result of the refusal will be a lagging of the flour trade and a decline in the price of flour. The slump in flour will cause wheat to drop, resulting finally in a falling off in production which will throw men out of employment, cause a reduction in wages, and general loss and discomfort to everybody. Obviously, then, I should be inclined to trust you for the flour.

But let us see why I do not trust you for the flour. If in this supposed case I am an American merchant and you are a merchant in Europe we will see what the situation actually is today.

Europe has been depleted by the war, and now stands in need of food and raw materials from us. At present the merchants of Europe cannot pay us for the materials they need, either in goods or gold. By means of our goods, however, those people could rise to their feet all the more quickly, and they would soon be able to pay us. We want to let them have the goods but here again the inefficiency of our financial system shows up to block business, and our failure to sell is detrimental, not only to them, but to us also, and is due to the fact that our financial system is not elastic enough to permit us to carry the credit.

Credit, as has already been noted, is made up of con-

fidence and time and the time is in direct proportion to the confidence. Little confidence, little time, therefore, the reason why bank credit it limited to 30, 60, and 90 days is because our banks are not sure enough of public confidence to let their credit out for a longer time. Bank credit is our medium of exchange—the means of carrying on trade—and the exporter can not use such short time credit for he must give his customer a longer time than 30, 60, and 90 days.

Because of the disrupted condition in which the war has left European industry the merchants there must have long time credit and our banking system because of lack of public confidence cannot carry it.

The Edge Act was passed as an amendment to the Federal Reserve Act in order to overcome this difficulty and under it the bankers are forming a one hundred million dollar Foreign Trade Financing Corporation so as to be able to extend the credit necessary.

The exporter is in exactly the same position as the farmer. He cannot use 30, 60, and 90 day money. He must have longer credit and since our banking system in its present condition cannot extend it this special institution is being gotten up for his benefit just as the Farm Loan Act was gotten up as an attempt to overcome the farmer's difficulties.

The Edge Act and the corporations formed under it like the Federal Reserve and the Farm Loan Acts are cumulative evidence that all financial reform is seeking to accomplish the result which can be accomplished by the remedy suggested in this book.

Our foreign trade suffers from the same old defect—

the false promise to pay gold, and a lack of confidence in the bank, due to private control. It is, once more, merely a repetition of the same old flaw. The situation that exists is the same as when lack of transportation facilities causes a freight blockade.

Here, then, we come back again to that flaw which is at the root of so many other evils, THE SELECTION OF A COMMODITY AS A MEDIUM OF EXCHANGE. It has been shown how this act, while a natural step in the evolution of trade, proved to be a mistake and has become the basic flaw in our whole social system. It has limited man's activities by limiting the volume of the medium by which his activities have always been conducted. In this way it has at all times subjected all industry to the will of the few who controlled the commodity used as an exchange medium.

This flaw has always caused and is still causing most of man's economic troubles, one of which is the present deplorable condition of our foreign trade and shipping business.

Business can be carried on only by using the medium of exchange. If, at any time, this medium cannot be had in sufficient quantity, the business must wait until it is supplied. The fact that the medium is limited today by the supply of a single commodity, gold, brings with it the natural effect that if the gold-supply is inadequate, business must wait until there is enough gold to carry through the exchange. It amounts to the same thing as waiting until a car is obtainable before goods can be shipped.

Now it is true that we no longer limit our medium of

exchange to the use of gold, since we also use paper and bank credit. We have greatly expanded our medium of exchange, for domestic purposes. Similarly every other gold standard country has expanded its medium for the same purposes, and by similar devices. But gold still remains the only universally accepted medium of exchange, and, consequently, the only means of settling international balances.

By making gold the basis of our medium of exchange at home, we have piled on it a mass of paper money and credit, which we promise to redeem in gold. Although we know this promise cannot be fulfilled, some gold must be kept stored away in vaults, so that through a complex system of reserves we can hypnotize ourselves into believing it to be true. Through the juggling of reserve requirements we have already stretched the little truth there is in the gold redemption promise to a point where, it is so thin that, any one can see through it, so there is real danger in stretching it any further.

In foreign exchange, therefore, we have a very intricate problem: the problem of getting the exchange mechanism big enough to carry our exchange operations and still keep it on the narrow-gauge gold track. All our gold supply is now used as the basis of credit at home. If we ship gold out of the country our reserve shrinks, and to get things back on balance, we must reduce our credit. But the percentage of gold reserve behind credit has become so small, or in other words, there is so much credit piled on so little gold, that a comparatively small shipment of the metal requires a very considerable curtailment of credit. This means a

contraction in the medium of exchange, and we know only too well the results of such an act.

The whole situation reminds one of the game of "jack-straws," or a similar game played with cards, where the deck is spread roughly on the table with two cards forming a house set on top of the pile. The object of the game is to see how many cards can be withdrawn without shaking down the house. And the object of the financial game, or the problem for some super-financier is: how can enough gold be pulled out from under the pile of paper money and credit at home to settle foreign trade balances, without shaking down the structure of credit?

At first sight this might seem to be a question, at present, for European countries to answer, but before we proceed much further it will be shown that it is our problem.

We shall not attempt to answer this question as above stated but it might be suggested, that if instead of keeping up the reserve bluff, we should put one hundred percent confidence behind our paper money and our bank credit, by the simple means of public control already explained, we could extend credit where credit was due and revive our drooping foreign trade. We would not need foreign trade financing corporations, nor any of the other devices intended to accomplish this purpose.

And here we come to the second factor determining the price of exchange. The first factor, the one which plays the larger part in determining the exchange ratio of foreign money, is the balance of trade. The second factor is the speculator, and the speculator comes into

the field only because the medium of exchange is so limited that foreign trade, like agriculture, cannot be carried on through the legitimate channels of credit.

Europe has been depleted by the war. Property has been destroyed, factories dismantled, material wasted, and business organization disbanded. Great quantities of raw material, machinery, food, etc., are needed for rehabilitation. Europe has no gold with which to pay for these things, and the credit of our bankers with its time limit of 90 days cannot be issued for a time sufficiently long to permit our exporters to get goods back in return for those shipped.

Some other way of payment for these exports must therefore be found. Gold cannot be used in payment, for the lack of confidence in banks, due to private control, keeps the gold buried in vaults to make good the gold payment bluff. The only way left open is to go to the speculator.

The American exporter takes the foreign purchaser's acceptance, or his drafts, or checks on a foreign bank, in payment for the goods. He cannot use these at his bank for his credit is limited by the banker's short time money, consequently he must sell these drafts to raise current funds so he goes to a speculator.

This involves selling the foreign credit at a discount, and since the greater the export trade, the greater the supply of those instruments of credit received and offered for sale, consequently the greater the discount.

And so the value of foreign exchange depends upon the price the speculator will pay for it.

Now the speculator's price will depend, not upon the

intrinsic value of the foreign credit, but upon the amount of it offered and the state of the money market. In other words, the price of "call money" in New York. The rate on "call money" then is the barometer not only for the prices of stocks and bonds, but for the price of foreign exchange. It is evident then that the discount rate fixed by a committee of New York brokers controls the price of foreign exchange and through it the volume of foreign trade, which in turn, affects the price of our exports, especially wheat and cotton.*

There are, therefore, two valid reasons why foreign exchange rates vary. The first factor is the balance of trade. When we export more than we import, that is, when the balance of trade is in our favor, there is created a demand for credit to the foreign purchaser. To obtain this credit the foreign purchaser offers his local credit in terms of the money of his location. This foreign credit is good but, like the farmer's credit, must run for more than ninety days so it is discounted to the speculator by the exporter because his bank is too weak in public confidence to carry it. When, as is the case today, there is much of this foreign credit and call money is high, the value of foreign credit goes down just as stocks go down, and all other prices tend downwards.

But what is the effect of this condition on the foreign customer? The greater the discount, the less his credit is worth to the exporter. The latter, then, must either raise his prices in terms of the foreign money, or quote them in terms of domestic money. In either case the foreign customer must stand an increased cost. This

*See Appendix, page 307.

cost increase is due to the discount which the speculator demands for turning foreign credit into domestic credit and not to any increase in the selling price of the goods, nor in the profit to the American producer.

The result is that this discount on foreign credit cuts down our export trade, because it continues to increase, without profit to the producer until the price of our goods to the foreign customer becomes prohibitive. He has to stop buying.

It is of the utmost importance to notice in this connection that the fall in exchange does not injure the foreigner so much as it injures ourselves. We are anxious to sell goods to them but the trade is stopped because our financial system is not big enough and strong enough to carry the exchange.

The same condition is presented as would exist if our shipping business were confined to the use of wooden tubs such as Columbus used. We are using a weak and antiquated system of finance which causes demand to automatically raise the price of our goods so high that other people cannot afford to pay for them.

This fall in exchange value puts a break on foreign trade just as a rise in the interest or discount rate puts the break on domestic business.

Again, we see the gold redemption promise and the private control which it fosters as unyielding opponents of prosperity and business expansion. It puts our industries and commerce in a strait-jacket and by binding our financial system to the service of private interests reduces our efficiency and retards our development. The gold payment promise is a molock against which

the banker is as helpless as the rest of us. Prosperity depends on business and business consists of exchange. We must make the medium big enough and strong enough to carry all that is offered just as we want a merchant marine big enough to carry our goods.

It is impossible to over-emphasize the fact that the abnormal rates of exchange existing today are more of a disadvantage to us than to foreigners, although they are apparently in our favor.

The fall in the price of exchange is generally supposed to militate against the interests of the foreign people by making them pay high prices. In reality it is just the opposite. It shuts their doors to our export trade but opens wide our door to imports.

The fall in the price of exchange operates in two ways against us. By making our goods dear in their money it shuts off our export trade and by making their goods cheap in our money it booms our import trade. This condition is just the reverse of the one desired.

To illustrate this point let us take the cotton trade as an example. Europe was our best customer in this line. When the war came and this market was closed there was a big slump in the price of cotton. The distress of our cotton growers at that time is quite memorable. Government purchases during the war relieved the situation, but now the price has slumped again because our foreign market cannot be restored on account of the exchange situation.

Take cotton that is worth say 40 cts. per lb. as it was in the spring of 1920, and say it costs 3 cts. to get it to England making the price in England without profit

for the seller 43 cts. per lb. The exchange rate of $3.50 per pound sterling for example made the price of cotton in England about 60 cts. per lb. And England naturally curtalied purchases to the minimum.

But note how the exchange rate affected Germany which would have been and still would be a very large buyer of cotton if our financial system permitted. The German mark, normally worth 23.82 cents in our money, has now fallen to around 1.5 cents, because the balance of trade is against Germany. This rate of exchange would make cotton costing 40 cents per pound in this country with a 3 cent freight rate cost in Germany almost 27 marks per pound or at the pre war dollar price of the mark $6.43 per lb. That is cotton that is worth 40 cts. per lb. here with a 3 ct. freight rate, is worth at the present price of exchange, $6.43 per pound in German money. Under such circumstances it is quite evident that Germany even though in great need of it will buy but little cotton.

Other European countries are shut out from buying our goods for the same reason as England and Germany are.

The foreign exchange situation is an illustration of the effect of our short time and shaky credit upon our foreign trade. The medium of exchange supplied by our banks under private control is not able to carry it. Our exporters are shut out of the bank for the same reason as the farmer always has been, and the automobile dealer recently has been. Through the weakness of our banking system legitimate business is driven to seek the speculator for financial relief.

Foreign exchange would practically come to par, and our export trade would be flourishing if our financial system were enlarged by the method suggested. This change would help the shipping business, the farmer, and everybody else. The Edge Act attempts to accomplish the same object but only by doctoring a symptom. A cure can be accomplished in a practical way by adding thirty words to the Federal Reserve Act as suggested.

CHAPTER XVII

NATIONAL EFFICIENCY

LABOR through trade supports and advances civilization. A means of producing labor and carrying on trade is, therefore, necessary. The only efficient way so far found is by rewarding effort. Slave labor proved inefficient because there existed a lack of incentive to work on the part of the slave. It consequently follows, that the better, safer and more accessible the means used to reward labor and conduct trade, the greater will be the civilization produced.

Since the efficiency of a nation depends primarily upon its trade and since trade cannot be conducted without the medium of exchange which is the present recognized form of producing labor and conducting trade, therefore, if the medium of exchange is not to be obtained the man power lies idle and resources remain undeveloped. Such a condition must exist until the medium of exchange is at hand to bring labor and the natural resources of a country together for the production of those things which improve living conditions.

But despite the great part that money or reward of effort has played in the development of the world's civilization little scientific study has been made of it. Although trade and commerce have been given a great deal of attention very little unbiased study has been applied to the medium so essential in carrying on the

process of trade. Most improvements in the medium of exchange have been the result of the slow process of evolution due to self interest, or to accident.

It is hardly possible to give too much attention to the elements necessary in an efficient means of rewarding effort and conducting trade.

It is evident that a financial system which for any reason is so restricted that it does not bring together the man power and the resources of a country will retard development. The effect is similar to lack of transportation facilities.

The medium of exchange must not only be safe and elastic but it must be available for use at all times. The greater the safety, elasticity and availability the greater will be the efficiency of the medium of exchange and the well being of the people will be in proportion.

It follows, then, that the different degrees of efficiency displayed by the people of different countries is due to a difference in their financial systems.

Most of the commercially important countries have adopted the gold standard so there is no difference in that respect. We must go beyond that point to find the real cause of their difference in efficiency. We must look into the conditions relating to the real medium of exchange, which is, in all commercially important countries, just as in this country, some form of bank credit. Consequently the variations we seek must be found in a difference in banking methods.

In this investigation, the first thing to be noticed is the fact that practically all European countries have long since adopted the central bank idea, which the

United States finally arrived at in a roundabout way through the adoption of the Federal Reserve Act.

The Bank of England, to name the most familiar bank of Europe, consists of a central bank with nine branches. It is a private corporation, managed by a board of directors, chosen by the stockholders, with a banking department and a note issue department, conducted separately. This Bank acts as reserve depository for practically all the banks of the United Kingdom, and has the exclusive right of note issue. This note issue is limited and is based on government securities and gold. The people are served generally by means of a number of lesser banks, privately owned and managed.

In this system there are two defects, the first being private management which precludes one hundred percent confidence and thus one hundred percent safety, and also precludes equal service to all members of the community. Such arbitrary power can not possibly be used with justice to all.

The second flaw is that in this system the volume of the medium of exchange is determined not by the demands of business, as it should be, but by the amount of government obligations and the value of the gold held by the bank.

The system is non elastic because of the fact that the only considerations for note issue are government obligation and gold. Neither of these elements are responsive to commercial activity or to the growth of business due to increase of population.

The English system, then, falls very short of the

mark of one hundred percent safety and one hundred percent elasticity. It is evident that no privately-controlled institution, operated for private gain, can hold one hundred percent confidence of the people, and the safety of any credit system is in direct proportion to public confidence.

As the amount of the note issue depends upon the government obligations and gold held, and as the volume of credit depends upon the amount of the notes put into circulation, it is evident that the system has a very low degree of elasticity. Its basis of note issue is in no way responsive to the fluctuating demands of business. Private control also detracts from elasticity, because it serves the interests in control and fails to serve the whole community impartially.

The Bank of France is a private institution with numerous branches. It is managed by a board of directors representing the stockholders. However, the government has a semblance of control through the governor and two deputy governors, appointed by the head of the state from among the stockholders. The bank has the exclusive right of note issue, the amount of which is limited by legislation. This amount is varied from time to time in anticipation of commercial needs. The note issue is based on the bank's assets.

While this system has passed beyond the folly of a gold reserve the fault in the system is still two-fold: in that private interests are in control, which detracts from safety and also from elasticity as in the English system.

Secondly, the note circulation is fixed by the legislature—a non commercial agency which prevents the vol-

ume of the medium of exchange from being fixed by the demands of business as it should be.

The Reichsbank, in the days of the German Empire, was a private institution controlled by a president and board of directors who were appointed for life by the head of the state and who were not permitted to hold stock in the bank. They were, therefore, government officials and not private employees. The bank had the right to issue a fixed amount of uncovered notes and a practically unlimited amount of secured notes, two-thirds of which were based on commercial paper and the other third on "cash" not necessarily gold.

This proposition of basing the note issue on the bank's assets, that is to say, mortgages, notes, acceptances, etc., was, no doubt, due to the fact that Germany could not procure gold as England could, for she had little foreign commerce at the time the Reichsbank was established, 1875, and no possessions where gold was produced. Consequently she happened to adopt a financial system which did not have gold as a basis of note issue.

This system, when put into effect, increased the elasticity of the medium of exchange for it was limited only by the confidence that the people had in the power that controlled the bank.

The good results were produced because the system gave a broader basis to the country's credit. Practically the only check on note issue was a tax imposed on the surplus when the reserve fell below thirty-three and one-third percent of the secured note issue.

Here then is quite a departure from the banking methods of other countries. This system was the only

financial system from which private control had been partially eliminated, and the only one which made commercial activity its limit of credit.

This difference of government control instead of private control, and this note issue based on commercial paper, the volume of which depended on business activity, were the points of excellence in the system which made it superior to others. In this superiority in her exchange system we find the real source of the much vaunted German efficiency and achievement. However, while this system fitted an imperial form of government it could not serve a democracy because the idea of public control in the case of Germany was due to the autocratic idea of making all interests subservient to the state. In a democracy, the United States for instance, public confidence could not be gained by such an arrangement. Confidence in banks to be secure here must rest on exact knowledge. The people must know of their own knowledge that bank loans are on good security.

But, the two provisions, of partial public control and a commercial basis for credits, supplied the necessary elements of safety and elasticity to Germany's medium of exchange in a greater degree than they were supplied to the medium of any other country, and, therefore, its efficiency was proportionately greater and was reflected in Germany's commercial achievement.

The commercial advancement here mentioned is in direct contrast with the commercial achievement of one of the largest nations of the world—China.

An old Chinese custom obliged every honorable Chinaman, as well as his eldest son, to commit suicide if, on

the coming of the Chinese New Year, he found himself unable to settle his outstanding debts and start the new year with a clean sheet. If he lacked the courage to impose death on himself and his unoffending son, he was sent to prison or perhaps to the headsman, and all his relatives to the forty-second degree "lost their face" until his debts were paid.

This system may have enforced honesty. It has often been referred to by American business men unable to collect bad debts. Economically, however, it was a most effective way of squeezing out of a people the last drop of initiative and enterprise. Each man played crabbedly and timidly and as a result, the people lived as miserably as rats in a country of good natural resources.

These natural resources have not been developed because China never has adopted a medium of exchange which would gain and hold the confidence of her people and that was elastic enough to permit her man power to be employed. Chinese exchange is carried on principally by the use of metal as a medium of exchange. This rigid and narrow exchange medium puts China into a financial strait-jacket. Imagine an American business man settling an account with a few bars of silver or a wheelbarrow filled with "cash," as the cheap brass coins, perforated and strung on strings are called.

China's lack of enterprise and progress is due to a financial system so cramped that it does not permit her man power to be employed sufficiently to supply the needs of the nation.

We have noted the financial systems of England, France, Germany and China and the different effects

which the different systems have had on the national efficiency of these countries.

History, instead of noting commercial advancement and its causes, consists of a chronicle of wars and dynastic and political changes with comemrcial and industrial development as a side light.

Could the history of the world be written in the light of real human achievement and well-being it would be found that advancement in civilization is due to improvement in industrial and commercial methods.

Industry and commerce are entirely dependent upon labor, mental and physical, and since labor is not a natural instinct of man, but must be induced by the hope of reward, it, therefore follows, that all advancement in civilization is the result of improvement in the means of producing and rewarding labor. That is to say, it is dependent upon the development of a more efficient medium of exchange.

Civilization is the result of exchange, therefore, social betterment is due to improved methods or means of exchange.

It follows then, that since the medium of exchange is the ladder by means of which humanity has climbed from barbarism to our present state of social development that further advancement is dependent on still greater improvement in this medium.

By taking note of known facts and by logical conclusions we have seen the value of safety and elasticity in a medium of exchange and found that the principle which produces these essentials is public control. The control of the medium of exchange must be expressed through a

system by which the volume of the medium is regulated by the requirements of business—the very principles advocated in these pages.

Public control can be secured in a perfectly democratic manner without any radical change. It implies no material alteration in our present banking and financial system. All that it really needs is the modification of the present system so that its control shall be in accordance with the principles we have demonstrated to be correct.

We need only to place the granting of loans on their intrinsic merits, displacing the private judgment of the banker with the exact information of the various markets, and of the assessor under a reformed plan of assessment. The right of appeal from the board of review or equalization, and a final settlement by a jury where personal interest dictates the verdict will absolutely guarantee correct valuation.

Public control of the greatest of our public utilities —our medium of exchange—would thus increase our present meager portion of individual and collective efficiency to a full one hundred per cent. Not only would we benefit personally and nationally but the cause of civilization and the welfare of all humanity would be advanced.

CHAPTER XVIII

THE CONCLUSION

SOME of those who have read these pages may feel that the change proposed will be an infringement upon the rights of the banker. They may still think that it is the banker's money that is being loaned and, consequently, they may feel that the banker should have no restrictions placed upon his loans. If it were his money perhaps he should be allowed to loan to whom he wishes, when and where and in any manner he pleases, but this is not the case.

To answer this possible objection we need only remind the reader that the banker does not lend money. He lends bank credit which has displaced money and is, therefore, a public utility. Its value rests entirely on the people's laws and the people's confidence and not at all on the banker's money or his personality. It will be seen, therefore, that the proposed regulation is not only justified but necessary. And if any doubt still remains, it should be swept away by a consideration of the enormous public advantages that would be gained. For when we reflect that the loans made by the banker constitute our medium of exchange, the tool with which we produce and carry on trade, the means by which labor is induced and rewarded, the element which every person must use in order to enjoy those blessings of life, liberty, and the pursuit of happiness guaranteed by our

Declaration of Independence, the situation is put in a very different light.

A person in a civilized community cannot apply his energies to the development of the resources of the country without the use of the medium of exchange. It follows, therefore, that control of this utility controls the energy, the activity and, in fact, the whole life of the community. The effect of bank control of this great public utility can be graphically demonstrated as follows:

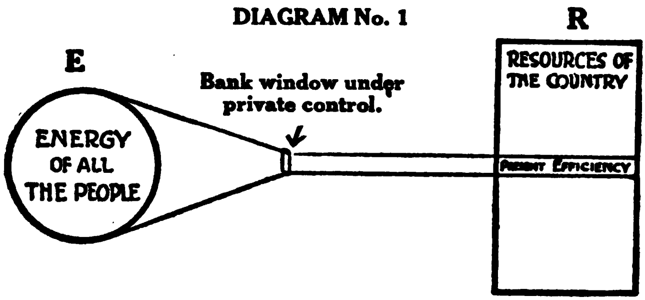
In the following diagram let E. represent the energies of all the people and R. the resources of the country, such as all the land, timber, waterpower, mineral wealth, etc.

In the United States there is about one bank to every 4,000 inhabitants so the bank window in the diagram should be about one four thousandth part of the size of the energy of the people.

With the bank in control of practically all of the medium of exchange, that is, all of it except the small change the merchant has in his till or the little we carry for minor necessities; it is evident that in order to use this public utility to any practical extent, the banker must be consulted. Therefore, the energies of the community cannot be directly applied to the resources of the country but must pass through the bank window as shown in diagram No. 1. Those who are fortunate enough to secure the use of the medium of exchange to an extent great enough so they can apply their energies will employ some of those who are not so fortunate, and, therefore, these lines, after passing through the bank

window, should diverge somewhat, in practice; but, if we consider only those who are thus permitted a degree of freedom of action, these lines should not diverge, but will be as in Diagram No. 1. We see then, that our present efficiency, with liberty, is compressed to a small portion of that which the whole energy of the people could produce. It is limited by the energy permitted, to get through the bank window.

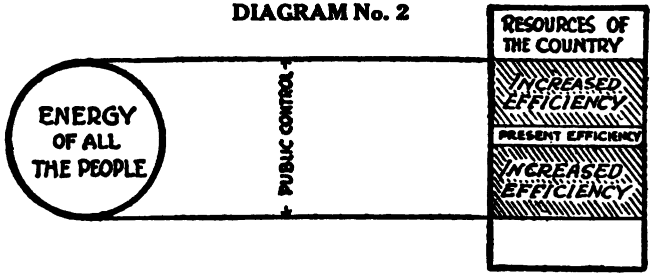
DIAGRAM No. 1



This diagram shows the result of private control of the greatest public utility which makes the use of the medium of exchange A PRIVILEGE.

Substituting public control for private control of our medium of exchange by displacing the private bank appraiser by a public appraisement and the "finance committee" of the directors by a public functionary would make the medium of exchange usable on the initiative of each individual and on the same terms by all. The bank window would be greatly enlarged and the energies of the people could then be applied directly to the resources of the country. This change would cause a great increase of efficiency as shown in

DIAGRAM No. 2



This diagram shows the effect of public control of the greatest of public utilities which makes the use of the medium of exchange A RIGHT.

By public control we would not only increase our personal and national efficiency from the present meager portion to 100%, but our liberty and democracy would be increased in the same ratio.

Social development decreed that something was necessary as a measure and as a means of rewarding effort. The first law of nature, self preservation, demanded and always will demand that the fruits of effort shall be enjoyed by the person making the effort to the exclusion of all others.

These considerations make two requisites necessary in whatever may be used as a medium of exchange.

First, the reward must be automatically bestowed because, if it is under the control of any person or group, the judgment and desire of that person or group will dominate the community and will result in injustice and also in the supression of individual effort and individual development. Even though the utmost honesty and unselfishness is used in exercising the con-

trol no other result is possible. The limitations of human nature set by the first law, self preservation, must give this result.

Second, whatever is used as such medium must have the confidence of the community in order to have value and its value must remain constant. Unless the value of the reward of effort remains stable a feeling of unrest and uncertainty will menace the community. The only value the medium of exchange has is its exchange value and if this value fluctuates then the medium is valuable only within the limits of the fluctuation. That is, the less it fluctuates the greater its value.

If the dollar received today buys but fifty cents worth a month or a year from today the reward of effort will be cut in half. Such an occurrence will most certainly create dissatisfaction and uncertainty. Business calculations will be upset, unforeseen losses will be suffered and a constant feeling of fear, unrest and worry will menace the community.

The defects in our system which cause these unfavorable phenomena and prevent us from enjoying personal liberty, security and confidence have been thoroughly explained and the remedy necessary to overcome them has been clearly set forth. Its adoption will give us a medium of exchange and reward of effort as perfect as any human institution can be made.

It has been thoroughly demonstrated that personal and national efficiency and well-being depend on the perfection of this medium, so with its improvement our personal and collective prosperity, comfort and happiness will improve in like degree.

No country in its medium of exchange has ever attained perfection in these two desiderata of elasticity and safety but some have approached it in a greater or less degree. It has been shown that the efficiency, progress and well-being of the various countries and peoples have always been in direct proportion to the nearness of this approach.

There still remains, however, one point which should, in justice to the banker, be clearly brought out. From what has been said it may be thought that the bankers are in some degree personally responsible for our troubles, since they are in control of the medium of exchange. This, however, is not so.

If the impression exists that any banker is in any way responsible for the defects in our present financial system or that he can be held accountable for our present or past economic ills such a notion should be dismissed.

The banker is a victim of the system along with the rest of the community.

The use of bank credit as a medium of exchange was developed because industrial growth made a greater demand for an exchange medium than the money metals could supply, so to continue to use metal alone would have held progress in a vise and checked development as it does in the case of China.

The gold standard, or the use of gold as a basis for credit has become increasingly more difficult as business and credit developed but it has been the only method so far known of holding public confidence in bank credit. It would never have been possible to persuade the people to deposit their funds in a bank had they not supposed

that the banker kept the money for them and would hand it back any time they wanted it. Since bank deposits make it possible to substitute bank credit for money a complicated system of reserve requirements developed for the purpose of continuing this illusion. An expose of the true state of affairs, even a few years ago, might have precipitated a panic, for our system at that time could not have withstood the shock of the truth. Now, however, with all financial reform striving to arrive at the point which this book shows how to reach by taking another short step in the same direction confidence will be increased instead of diminished by discussion and understanding. One conclusion is certain, since our exchange system is the result of evolution, no banker or anyone else, at the present time, is to be censured for its shortcomings.

The test of the banker's good faith and understanding will come only when he realizes that fiction and foibles have outlived their day of usefulness and that a logical and better way of securing public confidence is necessary. When the slight change herein suggested is fully understood, it will be realized that public control furnishes a practical method of putting bank credit on a safe and just basis. The change for the better, from every standpoint, is so obvious that even the most conservative banker will hardly attempt to argue that it is not an improvement on the present system. When the suggested change is understood, the practical benefits which will accrue, and the justice of the arrangement is so apparent, honest objection seems impossible. And, because it is all so American those who still advocate

clinging to the status quo can do so only for the purpose of perpetuating their present power and privilege. Such action would certainly be contrary to good citizenship.

In the proposed remedy there is not the least suggestion of a change in our money or methods of using it. There is no suggestion of change in business practice or methods or in the status of the bank. The only suggestion is to overcome the bankers' authority to dictate the use of the medium of exchange by the same means and for the same reason that we overcame the private control of the medium of transportation—the railroads. It suggests applying to the medium of exchange the same principle of public control which was applied to the medium of transportation through the Interstate Commerce Commission.

The proposed change does not even suggest that the banker give up his power without compensation, for it is proposed to give the banks SAFETY in exchange for POWER.

By putting bank credit under public control in the manner suggested every loan any bank could legally make would be perfectly safe. This end must be accomplished or our proposed change fails in its primary object which is to secure to bank credit 100% public confidence.

It has been seen that the suggested plan accomplishes this purpose because it prohibits banks from lending more than a safe amount on any security, and permits loans only on securities approved by the people themselves. With such a system in operation no bank could possibly make a bad loan.

Consequently, a great weight of responsibility would be lifted from the banker's shoulders, a relief which he alone can appreciate.

Under our present system the banker must be always on guard not only against schemers but he is constantly being asked to make loans to social or business associates on security or under conditions which he does not fully approve. Sentiment and friendship, however, prompt him to make many such loans. This yielding to a common human weakness causes worry and often brings unfavorable criticism and loss, so the banker is constantly torn between sentiment and judgment.

The proposed change would protect all bankers from both their friends and their enemies. It would even do away with the necessity for good judgment on their part for it would, by confining all bank loans to approved security, do away with the chance for loss.

No reason, other than a desire to retain power, is apparent why such a system should not be as welcome to the bankers as to the rest of the community.

With the assurance of safety which public control would give, the people would have 100% confidence in the bank. In that case there would never be a demand made on any bank for a money payment, so the necessity for a reserve, the banker's greatest worry, would be removed.

To be sure money would be used just as it is used now for small transactions and in all respects it would be the same money used today. The only difference would be that instead of having a hazy notion that money called for gold it would be known that it called for

credit. It would also be understood that the federal reserve note was simply a different form of bank credit and the delusion that it represents gold would no longer exist.

If the banker did not happen to have on hand all the notes desired by a customer, the Federal Reserve Bank would accept any piece of paper in any bank for its discount value in those notes. The people knowing that money could always be had would never call for it, or use it, except as a means for carrying on small transactions where it would be inconvenient to draw a check.

This change would make all good securities bankable and make all bank credit good money.

It has been shown that the only reason why a good security is not at present always bankable is either because the banker does not want to lend to the person who offers it or because it is not a liquid security. The reason why securities must be liquid now is because the people, lacking confidence in the bank, may wish to draw out their deposits and, consequently, securities must be such as can be quickly turned into money.

Public control would remove both of these reasons so that every good security would be a bankable security. The term "liquid" security would soon be obsolete. All security would be equally liquid and equally bankable.

With this change every branch of industry would have the same access to the use of the medium of exchange.

The automobile dealer would no longer be excluded because a few persons happened to decide that he was selling a luxury which ordinary people had no right to enjoy.

The farmer would no longer be a financial outcast because his occupation does not permit him to use thirty, sixty and ninety day money. The bank would no longer have a time lock on it against the farmer.

The exporter could extend credit to any length of time necessary to carry his trade and he would not be under the necessity of robbing his customers through the fall in the value of foreign exchange or of driving business away because of lack of credit facility.

Credit could be extended to any length as far as both time and amount are concerned. The only requisite would be sufficient security. As long as the security was good and the interest paid there would be no limit of time nor amount and no other consideration. There would be no control except the demands of business.

Every man would be enabled to stand on his own feet, use his own judgment and conduct his own business as he saw fit, without fear or favor. All legitimate enterprises would be readily financed because there would be no limit to the medium of exchange. Prosperity would not kill prosperity by causing a blockade of credits against the reserve requirement. There would be no freezing point for credit, so the wheels of industry would not be stopped by "Frozen Credits." Business would be always on the increase due to a constant demand caused by a continued rise in the living standard. There could be no "Buyers' strike" for desire is never satisfied so long as the means of turning desire into demand can be had. We would then have "normalcy" and our normal conditions would be one of peace and happiness. Science would advance, the arts be encouraged and

through a general, continued prosperity civilization would be extended to the utmost.

The flaw in our system which prevents the accomplishment of these desired ends has heretofore been hidden by the bad symptoms which it produced.

For instance, the most recent bugaboo, the H. C. L. has been shown to be due to a fluctuation in the value of the dollar. It is this fluctuation which causes the disparity between income and the size of the grocery bill, butcher bill, the cost of clothing and the rent.

If the fluctuation in the value of the dollar were stopped, industrial turmoil would stop, and the continued friction between capital and labor would be removed. The bridging of this chasm would surely be a great relief to industry and to society generally.

The value of all property and the price of commodities would be stable, varying only with the demand for and the supply of various properties and goods. Business could then be conducted with much more certainty and success would depend more on efficiency than on chance and not at all on the banker's favor.

A farmer would not plant and harvest a crop with dollars worth only fifty cents and be compelled to sell his crop for dollars worth one hundred cents due to the fact that during the summer the banks had shut down on credit. That is, he would not have to pay two dollars for everything he bought in the spring and receive but one dollar when he sold in the fall. He would then sell his crop for the same sized dollars that he spent for plowing, planting and harvesting. The changing value of the dollar between the spring and the fall of 1920

caused the price of farm products to shrink from one-third to one-half and even more.

If a thief stole from the farmer one-third to one-half of his crop the whole country side would be out to run him to earth and jail him. The object for so doing would be twofold. First, to keep the thief from robbing others and second, to correct the error of his ways. Since the banking interests did that very thing to the agricultural interests, when they "deflated" the medium of exchange between planting time and marketing time, would it not be wise to stop them from further marauding by correcting their ways of doing business?

Even the most complacent "stand patter" will hardly have the nerve to suggest "over production" as a reason for the recent fall in prices when half the world is in want. The fall in prices for most agricultural products during the summer and autumn of 1920 was due entirely to the weakness in our financial system. All such uncertainty, worry and loss could be done away with by putting into effect the remedy here given. Such an accomplishment is surely sufficient to fully justify the change even if there were no other advantages to be gained. However, let us examine a problem which caused much comment before the war and which is still the object of legislation and of court action. We refer to the trusts.

There is the "Beef Trust" and the "Coal Trust" and the "Steel Trust" and numerous other trusts. For the last quarter of a century the word trust with a more or less indefinite meaning has been made the scapegoat for all our economic ills. They are supposed to be both

father and mother to all the imaginary evils, such as the "H. C. L." and others.

When prices go up the ire of consumers is directed against "the trusts" and when prices go down the producers' wrath is directed against the same "trusts." This railing against "trusts' has gone on until now the word has come to be used as an epithet to describe, or rather to locate in a general way, what the user considers to be the cause of unsatisfactory economic conditions which he does not clearly understand.

Originally the word trust meant a business organization or an aggregation of business interests associated or consolidated for business purposes.

So described, the trust is, not only an outgrowth of human progress but it is an expression of advancing civilization because it co-ordinates effort and reduces waste. With this object in view it is the hope of the future for it will increase efficiency and thus advance civilization.

The evils charged to the trusts and the oppression which they no doubt have exerted is not the fault of the trust, but arises from the fact that those who control them also control the medium of exchange and by exerting their power over credit they naturally chill and check all enterprise not tributary to the trusts they control. In this way selfish interests curtail the producing power of the nation and this gives to the trusts a control over production and prices which they, by themselves, never could expect nor maintain.

No man, nor set of men, could monopolize the sources of production, that is, the raw material and at the same

time command the skill and labor necessary for efficient production, except through the control of a great public utility such as the railroad or the medium of exchange. We recognized this power in the case of the railroads and we thought we had overcome the difficulty when we put them under public control but it is quite evident now that we did not reach the real cause of the trouble.

It is readily seen that the trust, in itself, has no advantage in commercial competition unless it improves on methods of production or marketing. Its apparent power is wholly extrinsic, and is due entirely to money control not trust control.

This power of money is the prerogative of but one trust—the "Money Trust," which we have seen is neither more nor less than our banking system. The fact that those who control the trusts also control the banking system is so notorious that we need scarcely call attention to it.

When through public control we give to all, an equal right to use the medium of exchange the "Money Trust" will loose its power and all trusts will then appear in their true light. They will appear no longer as bogies or scapegoats but merely as combinations of interests for improvement in production and the advancement of trade. Advantage can then be gained only by reducing cost and when a saving is made in production or distribution the whole community profits because it is the object of civilization to supply man's wants with the least effort. If the trust does not succeed in reducing cost the combination will have failed in its object and will disappear.

There is another important improvement that will fol-

low public control which has not been noted and which will not be understood without considerable thought. It is not quite so apparent as other benefits but it will nevertheless be most welcome. This is the betterment which would come about by changing the motive which now prompts men to accumulate great wealth.

Starting out, of course, men strive to obtain the necessaries of life, then the comforts and then the luxuries. But when all these are assured by the accumulation of a great fortune why do men still strive for gain?

There can be but one reason, other than force of habit, and that is, men love power and the control of money under our present system gives it to them.

After accumulating a fortune, which assures to the owner and his family all the comforts and luxuries of life, a man will continue working and accumulating because of an instinctive love to dominate his fellow men.

Under our present political form of government it is only through the control of money that man can gratify this desire.

To limit by law the amount any man may accumulate or own, would result only in harm for it would put a limit to enterprise and would unnecessarily interfere with personal liberty, therefore, such action should be avoided.

Public control of the medium of exchange accomplishes the same object without destroying initiative, for when all are permitted to use the medium of exchange on the same terms the power of money will be destroyed. By divesting money of its power incentive to accumulate beyond the point where comforts and luxuries are assured would be removed.

Money, the medium of exchange, holds its power only because private persons control the money function through controlling bank credit and, therefore, can deny its use.

This money power exerts control in exactly the same way as the railroads formerly did or as any other public utility would in proportion to its importance. Any facility which must be used by all the members of the community would give to those who could control such a facility power over the community. Bank credit is such a facility, for it is our medium for carrying on trade and all must use it to make a living, so its control gives power. But, when the private control of that medium is overcome by permitting all to use it on the same terms, the "power of money" will be destroyed.

The homage which is paid to wealth today comes from a mistaken idea that the power of money is due to wealth. Therefore, a natural thirst for power and prestige induces men to accumulate wealth beyond their needs only for the purpose of gratifying a common human weakness.

In this connection, the terms wealth and money must not be confounded nor misunderstood. Let us define wealth as any piece of property of value such as a building, a piece of land or a quantity of merchandise. It is quite evident that nothing of that kind can exert power because none of us are compelled to use any particular building, piece of land or certain lot of merchandise. If we cannot secure what we want at our price we can do without it, we can use something else.

But, if money is defined as the medium of exchange,

it is a very different story for we must all use that.

We cannot produce the things necessary for life nor carry on business without using the medium of exchange. In fact its use is much more necessary in the every day affairs of the community than the railroad or any other facility. No exchange of goods or of services can take place without it, so to keep it from controlling us we must make its use a right.

As long as the use of it is a privilege which can be denied we give to those who control it a most complete power over us. Since the medium of exchange is almost as essential to industry as air and water are to physical existence, the power which controls it has practically supreme control over the community.

We see, therefore, that wealth has no power because we are not compelled to use any certain piece of wealth, but the medium of exchange has because we are all compelled to use it. The power of money arises from the fact that its use, while necessary, can be denied. It is plain, therefore, that if our exchange system were so arranged that the use of the medium could not be denied, that is, so that all could use it on the same terms, the power and prestige of money would be overcome.

Up to the point of supplying our wants, efforts to acquire wealth are spurred by a desire to better our condition, or in other words, to raise our living standard. This ambition should be encouraged but beyond the point of satisfaction of desire it is merely the love of money for the power it gives that induces the effort to accumulate.

It is evident then that if power is taken from money,

avarice, which is the love of money for money's sake, will be destroyed. With its power gone neither money nor wealth from which its power is supposed to spring would command homage nor cause envy and class hatred.

Without power, money would be merely a commercial tool and there would be no object in piling it up any more than there would be in gathering up a hundred hammers when one hammer would do the work.

Such a condition would bring about many improvements in our social as well as in our industrial life. The homage now paid to wealth would disappear. Property would be accumulated only to satisfy an ambition to live well. When a sufficient income was secured to assure the satisfaction of desire, the accumulation would cease for there would be no object gained or purpose served in accumulating more.

Industrially, public control would open the door of the bank to all branches of industry and remove the present restraint on production and trade. Efficiency and square dealing would replace favoritism and chance in business.

Aside from the industrial and social advantages to be gained by public control of bank credit there is yet another advantage not to be lightly considered. That is, the improvement in moral standards which would follow the change of the basis for bank credit from the false promise of gold redemption to one of real security and truth.

That our present system of credit rests on a false promise, that of gold redemption, covered by a smoke screen of reserve deception, cannot be denied. Such a condition certainly is not conducive to good faith and integrity in any of our dealings. But, when the founda-

tion of our greatest public utility is changed to one of truth and honesty as suggested, then honor instead of cupidity will be at a premium.

When the bank's power is destroyed, as the railroad's power was, push will displace pull as the requisite for business success and the man instead of the courtier will win.

When the suggested change is adopted the financial system will enable every man to stand on his own feet and will grant him success according to his own efforts.

The citation of existing evils, which would disappear and of improvements in our industrial, social and moral status which would follow from the proposed change in the financial system, could be carried to indefinite lengths. However, enough has been said to thoroughly establish the fact that all members of the community would be benefited and no one would be injured by the change.

In the proposed remedy there is no suggestion which is not clearly and directly in line with American principles, ideals and experience, and also in direct line with financial evolution and development. It is but one more step in advance along the same highway of progress which civilization has followed from the beginning.

However, in order to forestall the usual cry of "radical" the fact should be clearly noted that the only change suggested herein is to extend our well established principles of public control of public utilities to include the medium of exchange. Experience has taught the American people that public control of public utilities is necessary in order to put into practice the principles of liberty and equality on which our nation was

founded. Consequently, when it is definitely established that the medium of exchange is a public utility, one cannot oppose the suggestion of public control for it and still be considered a good citizen.

On the contrary, it becomes the patriotic duty of every good American to spare no effort to secure this change for it is necessary in order to realize the principles of liberty and equality which the American people have proclaimed to the world as being the foundation of their government.

APPENDIX

Appended are verbatim copies of official documents furnished by the Comptroller of the Currency. They speak for themselves and supplement and support the text. The facts set forth in these documents are quite startling to those unacquainted with "Wall Street" and as they are based on the statements of the banks themselves they should be carefully read.

NOTE

The side notes are intended to call attention to the points where these official documents supplement the statements made in this book. After reading the appendix a review of the chapter on the "Federal Reserve" and those following it will convince any reasonable person that a revision of our exchange system is necessary and a review of Chapters VII and VIII will show that the remedy suggested here is practical and complete.

FOR THE PRESS

OFFICE OF COMPTROLLER OF CURRENCY

The Comptroller of the Currency said today:

NEW YORK CALL MONEY RATES HIGHEST IN THE WORLD

Unjustifiable Interest Exacted on Demand Loans Aggregating Billions an Active Contributing Cause of Exorbitant Rates for New Capital Charged Cities, Railroads, Industrial and Other Public and Private Enterprises and for the Huge Shrinkage During the Past Year in All Security Values.

"Renewal" Rates Fixed Daily by Small "Coterie" of Stock Exchange Brokers Govern Interest Charged on Brokers Loans in Nearly All New York Banks.

In a statement given to the press on July 31, 1920, I expressed the opinion that there was no justification for the excessive and burdensome interest rates "running up to ten, twelve and fifteen per cent and higher, which had been exacted by some of the banks in New York City, the principal financial center of our country."

It is no part of my business to discuss now the morality or the ethics of these transactions. It is my imperative duty to take close cognizance of them so far as they may have effect on the general banking and com-

mercial interest of the country. I realize clearly the inestimable and indisputable value to our own country and the world of the great money center popularly known as "Wall Street;" and have no purpose or wish to stir prejudice against it, or to do or say anything to impair its usefulness or to injure any institution or individual connected with its activities. I do intend, strictly in the line of official duty, to put before the public and the newspapers facts of which both are uninformed and to point out evils already existing and dangers threatened because of those facts.

WALL STREET

In the statement of July 31st, I called attention to the fact that New York was the only city of consequence in the world where such interest rates existed or are tolerated and I expressed the belief that the exaction of these rates, the publicity given them, had increased the uneasiness in financial circles and had been an active contributing factor rather than a consequence, in the unsettling of security values, and that they had operated to force railroads and industrial corporations to pay burdensome and costly rates in providing fresh capital for the industries and business of the country. I also pointed out that the banks which had been charging their customers these excessive rates

EVILS OF USURY

> "at times as high as fifteen per cent or more have themselves at the same time been liberally accommodated with millions of dollars by the Federal Reserve Banks at average rates of considerably less than six per cent."

This press statement was vigorously attacked in the columns of the New York papers in interviews with vari-

ous anonymous bankers and financiers who refused, however, to permit their names to be used. One leading journal, for example, quoted bankers as saying:

"It is unfair to attempt to defame the whole New York banking community just because of one or two possible insignificant instances of abuse."

Another leading New York paper declared that the high rates quoted on the Stock Exchange applied only to "a small amount of money relatively speaking."

The investigation which I have made since my public statement on this subject completely confirms the views expressed and proves that they were, if anything, too conservative.

In order that the public might be fully informed, and know the exact facts in regard to the money situation in New York, the national banks in New York City were requested by the Comptroller of the Currency, under date of August 5, 1920, to furnish, under oath, a report of the number and amount of all demand loans secured by bonds and stocks made monthly by them between October 1, 1919, and July 31, 1920, upon which they had exacted interest *in excess* of six per cent per annum. The banks generally, including the largest bank in New York City, complied with the request, but three banks demurred, claiming that it would be impracticable for them to furnish the data called for as to various loans made by them at excessive interest rates by months as requested. They were, thereupon, requested to furnish information as to the loans made by them for about eight days in each month since October 1, 1919, these eight days including, generally, the high money periods in each

BANKS CONVICT THEMSELVES

month. It should be understood, therefore, that in the statement which follows, three of the larger banks have included only a portion, and not all, of their loans made at the high rates.

The banks were requested, in submitting their statements, to count as a new loan each change in the interest rate on their existing call loans. If a loan, for example, should be made for $100,000 to a brokerage firm by a certain bank at 10%, and the rate changed five times in 30 days, this loan would be regarded as six loans with an aggregate of $600,000. Therefore, these demand loans embraced in this statement should be considered as running from one day upwards. It should also be explained that, in the case of one of the three banks which reported its loans for only a portion of the period, call loans are included which were made by this one bank for outside banks as well as for itself. These outside loans sometimes amounted to more and sometimes to less than the call loans made by the bank for its own account.

30% INTEREST

The sworn reports to this office show that during the period from October, 1919, to August 1, 1920, there were made by the national banks in New York City more than 4,000 loans, at rates of 15%, 20%, 25% and 30% per annum, and that the amount of these loans, including only a portion of those made during this period at the above rates in three of the largest banks, aggregated over Six Hundred Million Dollars ($600,000,000).

The records also show that the total loans outstanding upon which interest at 15 to 30 per cent was being charged by a portion of these banks on 42 different

days, for which reports were received from them, aggregated over $1,100,000,000. It will be remembered that in my statement of July 31, the banks were charged with making loans at "10%, 12% and 15%." The actual facts, therefore, in view of the loans made at 15%, 20% and 30% indicate that my statement was extremely conservative.

THE CONFESSION

The records also show that the amount of loans made during the same period at rates in excess of 10% and up to but not including 15% amounted to over $1,400,000,000, there being over 11,000 of such loans.

In addition to the above the aggregate of the loans upon which a portion of the banks reported that they were charging, on 81 different days, interest in excess of 10%, and up to but not including 15%, was about $900,000,000. The "brokers" or "Street" loans upon which the New York banks, during the period referred to, were charging MORE THAN eight per cent per annum and up to 10%, reach, in the aggregate, some billions of dollars additional in amount and tens of thousands in number.

It should be understood that these loans (except in the case of one bank) represent the money loaned by the banks for their own account, and the figures do not include the loans made for their correspondent banks.

"CALL MONEY"

As a result of persistent inquiries among the banks, brokers and stock exchange authorities, this office is now, for the first time, able to inform the public as to how the so-called "renewal" rate is made from day to day in the New York Call Money Market, and the extent to which this money rate is observed by the New York

banks in making their charges on ordinary Wall Street or brokers' loans.

Under the New York banking law, it is lawful for a lender to charge any rate of interest which may be agreed upon with the borrower on a demand loan for $5,000 or more secured by stocks, bonds or other securities. This provision of the New York Statute enables lenders to escape penalties for usury which exist in most of the other States.

THE "PUMP HANDLE"

From information furnished this office, through different sources, it appears that every business day a coterie of brokers, members of the New York Stock Exchange, get together for consultation on the floor of the Exchange, or by telephone, and determine what, in its view, is the proper rate for the renewal of all street or brokers' call loans for that day. As soon as the rate is agreed upon the President of the Stock Exchange is notified, and the rate is posted on the floor of the Stock Exchange at, say, 11 o'clock.

RATE ON BROKER'S LOANS

This rate is then sent over the "ticker" to all the banks in New York City and these banks thereupon mark up or down, as the case may be, the rate of interest upon practically *all* their Wall Street or so-called brokers' loans. Some banks take the precaution to notify their customers by card, sent by mail or otherwise of the change in interest rate on their loans, while other banks do not. They claim that the posting of the renewal rate on the floor of the Stock Exchange serves automatically to raise or lower the rate of interest on this character of loans, held by all the New York banks, for themselves or their out of town correspondents, and their customers are

charged the rate so posted, unless they make special arrangements with the bank to the contrary, or pay the loan.

In the questionnaire sent by the Comptroller of the Currency to all the national banks under date of August 5, 1920, each bank was asked the following question:

"Has it been the practice of your bank, during the past six months, to mark up or down, from day to day, according to the fluctuations of the New York Call Money Market, the interest rates on demand or call loans, secured by bonds or stocks, made to borrowers who are not depositors in your bank?"

BANKS PLEAD GUILTY

In reply to that question every National Bank in New York City with two or three exceptions answered "Yes," and two of these stated that they too, under certain conditions also charged the "call money" rate.

It is fair to say, however, that nearly all of these banks with a few prominent exceptions stated that it had not been customary with them, in making advances in rates, to increase the rates on demand or call loans made to their own regular customers who kept deposit accounts with their banks and that these regular customers were treated differently from the ordinary brokers or Wall Street borrowers. It is also worthy of note that demand loans, secured by stocks and bonds, made by banks to their own officers and to the officers of other banks are also generally exempted from the high interest rates.

FAVORITISM

It is also fair to state that the reports in this office show that despite the huge volume of loans made at fancy rates, less than one-half of the National Banks in New York City reported that the demand loans made for

their own accounts at rates of 15% or more, aggregated for each bank over ten million dollars between October 1, 1919, and July 31, 1920.

In their reports to this office of September 8, 1920, the national banks of New York City reported that they were lending *on demand,* on bond and stock collateral over $348,000,000.

The national banks in New York City also reported that on August 1, 1920, the amount of money which they were loaning on demand, on bond and stock collateral, in New York City for account of customers and correspondents was $524,000,000.

It is fair to assume that the Trust Companies and State Banks in New York City were lending demand on stocks and bonds as much as the National Banks.

The Stock Exchange authorities state that the posting of the "renewal" rate on the floor of the Stock Exchange does not make it compulsory with the banks to charge such "renewal" rate. Attention, however, must be called to the fact that *nearly* every National Bank in New York City has admitted that when the rate is posted, the rates charged on "brokers" or "street" loans are changed to conform to the prevailing Call Money Rate and the only alternative for a borrower is to *pay his loan* or be charged the posted or current rate. As nearly every bank in New York charges the so-called "renewal" rate on what are known as Wall Street or "brokers" loans, it would be vain, obviously, for borrower to hope to obtain the money in New York at a lower rate by shifting his loan to some other bank.

THEY ALL DO IT

THE STRANGLE HOLD

Despite the statement of the banks generally that the

interest rates on brokers' loans are raised or lowered simultaneously with the fluctuations in the New York Call Money Market, many instances of apparent discrimination were developed which show wide differences in the rates charged on demand loans equally well secured. For example, when the "renewal" rate for a certain day within the last twelve months was posted, on the Stock Exchange at 16% the report of one particular New York bank showed that on that date this bank was charging on loans for itself and correspondents:

DISCRIMINATION PROVED

7% on $4,900,00
8%, 9%, 14% and 15% on $1,428,000
18% on $750,000
20% on $42,100,000
25% on $3,550,000
30% on $900,000.

INSIDERS

The coterie of brokers who fix the "renewal" rate, which appears to have such binding force upon the banks in New York City in the case of brokers' loans, does not limit its activities to loans but these brokers also execute orders for stocks and bonds on the floor of the Exchange. Inquiry of the Stock Exchange as to the number of brokers who are usually concerned in the fixing of the money rate, brought the reply that there were, as a rule, "4 to 8 or more," the Stock Exchange being usually represented by either the President or "one or more" of its governors, in the consultations where the rate is fixed.

WORKING THE MARKET

On November 10, a year ago, this brokers' committee announced that the renewal rate on Call Loans would

be 12%. The following day, November 11, they raised it to 14%. On November 12 the rate was raised to 16%; November 14 it dropped to 14%; on November 21 it was made 8%, although other loans were made as low as 6%. On December 18 it was 6%; December 23 it was raised to 10%; on the 29th to 12%; on the 30th to 15% and remained at that rate until January 5 when it was lowered to 10%. On January 31 the renewal rate was 12%, the next day February 1 it was advanced to 18%, dropped to 14% on February 2; advanced to 17% on February 5 and remained at 17% until February 9 when it was reduced to 14%. On February 17 it was 6%, raised again on February 26 to 10% and continued at 10% until March 4 when it was reduced to 9%. On April 16 the renewal rate was again 10%. In May the highest renewal rate was 9%. In June the rate was 9% from the 25th to the 30th. July opened with a 10% renewal rate. It was lowered during the month but returned again to 9% on the 16th, 17th and 27th. It is gratifying to note that since the publication of the Comptroller's statement of July 31, regarding excessive interest rates, the 'renewal" rate does not appear to have been advancd again as high as 10%.

A TOUCH OF PUBLIC CONTROL

It seems clear from the figures submitted that the amount of demand or call loans in the National and State Banks and Trust Companies in New York City, plus the loans placed by them for their correspondent banks, which are effected by the rate fixed by this Committee of the Stock Exchange, probably EXCEEDS one thousand million dollars. As I pointed out in a previ-

ous statement, on this basis an advance in the "Renewal" rate from 6% to 18% for one day would add $360,000 to the net profits of the lending banks for that day. In the first part of January of this year, for example, the 15% "renewal" rate exacted for six successive days meant, on this basis, a net interest profit of about $3,000,000 or more for those six days.

"PROFITEERING"

The raising or lowering of the "Renewal" rate on the Exchange is frequently accompanied by upward or downward movements in stocks and securities; and those responsible for the fixing of the rate therefore have the opportunity, whether exercised or not, of profiting largely by operations on the stock market, which is so often and directly effected by the call money situation. I do not, of course, undertake to say that this informal "money committee" does take improper advantage of their foreknowledge; but there are critics who severely censure the existing arrangements. Certainly all prudent and thinking business men will agree that there is danger in the concentration of such opportunity and power in the hands of a few persons. Temptations to use this power for individual profit must arise, and human nature is not changed by high position in the financial world.

A CROOKED GAME

Mr. Lincoln's axiom that God never made a man good enough to be entrusted with unlimited power over another man may be supplemented with the suggestion that no four, or six, or eight men are strong and pure enough to be entrusted with unlimited power over the finances of a great country without direct responsibility and accounting for their acts to the public or some other potent and intelligent authority. Power to fix

LINCOLN SAID

money rates for all, or nearly all, of the banks in New York City, and to change them daily, is a grip on the heart of our commerce. It permits such interferences as fallible human judgment, whim or interest may direct with the natural and orderly movements of money, the life blood of business. Many of us complain bitterly when we fear that the two houses of Congress, State Legislatures, or State or Federal administrators, acting in the open, and after debate and public hearings, have interfered with natural laws of trade. We condemn radical writers and speakers who advocate such interferences and regard them as public enemies. Yet the matter of arbitrarily fixing money rates at the money center, possibly reversing the natural and healthy flow and affecting, directly or indirectly, billions of dollars of security values and other property, is left to a small and varying number of private citizens without official responsibility, deciding in a moment and in secret.

AUTOCRATIC POWER

RADICALISM

DANGEROUS AND HARMFUL PRACTICE

The evils and dangers of such methods could be recited indefinitely. They reach to the remotest corners of the Union and its possessions, and touch harmfully every class of people. The direct tendency is to reverse one of the fundamental purposes of the Federal Reserve Act, which is to promote orderly distribution of money through the country to meet the needs of commerce and agriculture.

Excessive interest rates offered in New York artificially draw money away from outside communities and often leave legitimate enterprises starved or pinched, while feeding speculative movements which may be adding nothing to real industrial or commercial wealth.

I reiterate the statement previously made that the excessive rates on call money, arbitrarily fixed and tolerated in New York, in my opinion, have been a potent influence in depressing seriously the prices of all investment bonds and standard shares, the shrinkage in which in the past twelve months has amounted, including the depreciation in Liberty Bonds to several billion dollars.

BILLIONS LOST

It is no part of the function of a Government official to moralize on speculative operations. My attention is demanded when such operations produce conditions retarding the development of the country and endangering the stability of its business. Corporations, individuals and investors generally are drawn away from legitimate investments in new enterprises and in the shares and bonds of existing enterprises by the prospect of 10% to 20% interest.

EVERYBODY HURT

The effect of these rates is seen when the general managers or executives of railroads or other large corporations visit New York to raise money necessary for the redemption of retiring loans or for the extension and promotion of new business. The bankers and bond brokers solemnly point to the high rates paid for "call money" and corporations whose credit abundantly justified a 5% or 6% interest basis, have been forced to pay 7% or 8% or 10% on loans for one year, three years or five to ten years; and are sometimes persuaded by the bankers through whom they obtain the funds that they are doing well to get money even on such terms, because money on call has been advanced often artificially to 12% or 15% or 20%, for a few days at a time.

THE GARROTE

The sophistical argument that a high rate for call loans is a justification for a long time loan at 8%, 10% or 12% by a strong and solvent corporation is transparent, but many excellent corporations have, during the past 12 months, been forced to accept loans at exorbitant rates of interest for term of years which will inevitably, in some cases, prove a serious embarrassment and handicap in their future operations.

ALL ARE VICTIMS

The same cause that cripples and hampers a great railroad system or a municipal government also deprives and injures or ruins a country storekeeper, a small farmer or the owner of a large or little manufacturing enterprise.

The argument that these high money rates prevent panics by enticing call money from banks and others in the interior to New York will not bear analysis. The facts are that much of the money drawn from the interior and loaned on call in New York at fancy rates would, but for the temptation of the high rates and the fear which they instill as to the future of the security market, be used by investors and banks and corporations who have those idle funds in the purchase of standard railroad and other bonds; which would thus furnish funds to the New York market normally and naturally.

The high rates for call money in New York have thus shut off a large part of the investment demand for securities, which, during the past 12 months, largely because of those disturbing conditions, have been forced down to the lowest prices reached in 40 years.

It is my belief that if the call money rates in New York had been maintained at 6%, or at the maximum

rates which are charged in other money centers, as I believe could have been done with a reasonable degree of co-operation upon the part of the New York banks, the unprecedented shrinkage in security prices in the past 12 months would not have taken place and the apparent loss of billions of dollars in values would have been avoided.

NEED OF REFORM

My hope for the present is that, with the public in possession of the facts, sentiment will be strong enough to bring about reforms. Money rates should not be raised or lowered or manipulated arbitrarily or in secret. New York bankers and financiers have tremendous responsibilities to the general public, and all can be induced to realize and respect them, as some honestly and conscientiously do now. Bankers throughout the country should have impressed upon them that they owe direct and distinct duties to their customers and communities, in preference to earning excessive and questionable profits for stockholders and themselves, by pouring money into New York for interest exactions which inevitably most injure or destroy somebody. The best banking is the broadest and most foreseeing—that based on the conviction that the real, permanent, stable profit in business is in building up, encouraging and developing in their prospective spheres, not in starving the productive elements of communities in the hope of grabbing large profits from the speculative.

OBJECT OF REFORM

Reports showing the extent to which, as referred to in my statement of July 31st, banks in New York City and elsewhere have, during the past year, been obtaining funds from the Federal Reserve Banks at rates varying

from four and one-half to six per cent and have loaned these funds in New York at the excessive rates referred to, running, in some instances, as high as 20%, 25% and 30%, are now being compiled. A statement concerning these transactions will be made later.

October 22, 1920.

Comptroller of the Currency said today:

MILLION DOLLARS OF N. Y. LOANS CONSTANTLY AFFECTED BY RATES ARTIFICIALLY FIXED

Additional Examples of Loans on Which 20% and 25% Are Charged. Interest and Discount Collected by N. Y. National Banks, 6 Months Ending June 30, 1920, Was About $100,000,000 Which, as Compared with Same Period in 1917 Is an Increase of about $50,000,000 in Interest Collected.

LET THE BANKERS SPEAK UP

Criticisms on the statement given out by this office for the newspapers of Monday last seem to me to be rather vague and feeble as well as anonymous. I hoped they would be strong, illuminating and constructive. I am constrained to believe that they do not express the thought of the bankers of the country or of New York, who certainly are men of ability, with intelligence and courage to speak clearly and frankly when they wish to speak.

One of the functions of this office is to do all possible to maintain and increase the goodwill and confi-

dence of the public in the banks of the country. To that end continual labor, frequently troublesome to all concerned, has been applied to make sure that the management and conduct of all banks should be such as to deserve goodwill and confidence. Following along that same line, I think it right to reiterate some expressions included in the statement referred to, but unfortunately omitted by many newspapers which published portions of it. These are, that there is no purpose in this office to stir or cater to any prejudice against that great and useful part of our financial system popularly known as "Wall Street"; that there was and is no purpose to hold up the New York City bankers or any other bankers for special condemnation. It is my duty to discover and oppose what I believe to be evils and dangers threatening or impeding the business of the country. There has been no attack on individuals or individual interests. The criticism from this office has been against a system and method. The first step toward correction of any wrong must be discovery and exposure.

PUBLIC CONFIDENCE NEEDED

Statements of the existence of extortionate interest rates in New York, affecting the operations of the whole country, made by me some weeks ago, were met by sneering denials through newspapers. Thereupon it became necessary to present confirmatory specifications and evidence. This has been done. Anonymous and indefinite denials are not contradictions. Statements of facts and figures, sworn to by the banks themselves, cannot be met by excited rhetoric or general denunciation, or unsustained accusation of improper motive.

CRITICISM JUSTIFIED BUT NOT APPRECIATED

In my previous statement I showed that the aggre-

gate of these Demand or Call loans secured by bonds and stocks handled by the New York banking institutions for their own account and for account of their correspondents, upon which interest rates varying from 7% to 30% have been charged, has probably averaged throughout the past year more than ONE BILLION DOLLARS.

OFFICIAL REPORTS

The assertion by anonymous critics that the exorbitant interest rates were rare and applied to insignificant sums will not weigh against official reports made to this office under oath. We find, for example, one National bank declaring that loans made by it in the period covered by my statement at rates in excess of 10% per annum, aggregated $448,000,000, including $186,000,000 (1426 loans) at rates of 15% and over. On a certain day within this period another bank reported that, on loans for itself and correspondents, it was charging 15% on $55,895,000, and 18%, 19% and 20% on $3,600,000 additional. The same bank admitted exacting on another day 18% on $57,183,000, 20% on $1,400,000 and 25% on $14,055,000. On three days early in January the amount on which this bank was charging 18%, exceeded $63,500,000.

ROBBERY

Another New York national bank reported that it was charging on a certain day on loans made for its account, 16% on $23,500,000 while two days previously it was loaning at 14%, $27,100,000 and at 16% and 18% $315,000 more; another day this bank reported that loans at 17% to 20% exceeded $17,000,000. On December 31 last the same bank made 11 new loans for over $2,000,000 at 25%, and on January 2 it made

53 new loans aggregating $10,000,000 at 15% in addition to some millions already out at 15%.

Still another bank reports that, on a particular date during the past year, it was charging on loans for its own account, 25% on $2,150,000, 13% on $300,000, 15% on $10,900,000. On another date the same bank was charging 22% on $2,000,000 and 11% to 16% on $8,200,000 additional, with other loans at the same time bearing 7%, 8%, 9% and 10%. This particular bank has through this period been lending, as have other banks, many millions more at exorbitant rates for correspendent banks. The foregoing figures relate to only four of the thirty-four national banks in New York City and they are matters of record. INSIDERS AND OUTSIDERS

It is of interest to the public that most of those New York banks, a few of whose loans are given above, while lending at these very indefensible rates, sometimes 25% and 30%, were being accommodated at the same time at 4½% to 6% by the Federal Reserve Bank of New York with sums as great or greater than their loans recited above. They were, therefore, occasionally charging borrowers 20% to 25% more interest than the rates they paid the Reserve Bank. SOME PROFIT

The amount actually collected for interest and discount by the thirty-four national banks in New York City for the six months ending June 30, 1920, exceeded all previous records, and amounted to approximately One Hundred Million Dollars ($100,000,000), which was nearly Fifty Million Dollars ($50,000,000), or nearly 100% in excess of similar receipts for the corresponding period in 1917. THE "SWAG"

In February last, the "Renewal" rate in New York City for the whole month averaged above 10%. This was more than double the normal average for call money.

While nearly every national bank in New York City has admitted that its rates on the so-called "street" or "brokers" loans are marked up or down automatically from day to day according to the fluctuations of the call money rate, yet reports from some banks show a marked discrimination, and that they exact on some of the well secured loans rates considerably in excess of the so-called daily "Renewal" rate, while other banks adhere quite closely to that rate.

As to the large amount of call loans held by national banks for account of correspondents (over $500,000,000) it may be of interest to state that the New York banks, for their services in handling these loans, make varying charges—sometimes a fractional commission is charged; sometimes, in view of the deposit balances carried, no charge is made; while at other times, the New York bank and its outside correspondents divide evenly the interest collected in excess of six per cent per annum.

DIVISION OF LOOT

New York, as I have stated before, is the only city of any importance in the world where such interest rates as these exist or are tolerated. They have, in my opinion, been most costly to the entire country and can not be justified on any basis of economics or ethics.

REAL PATRIOTISM

The plainly, indisputably proper course is change of policy and reformation of abuses which have come almost imperceptibly, not loose and wholesale criticism of the man trying to heave the lead line and give warning of shoals.

The point is not the qualities or intentions of the official, but whether the shoals are there. My work is to report them and prove where they are. My strong faith is that the bankers of the country will find and apply cure for the evil that has been shown. They have on them now some of the heaviest and most difficult responsibilities which ever rested on a financial body. The welfare not only of their own country, but of the world, depends in a great measure on their wisdom and character. I believe they will meet the test. The most important part of the Comptroller's work is to help them, as he may. There is no better way to help than to detect and point out obstacles and perils in their path toward performance of the tremendous work they have to do.

FOR HUMANITY'S SAKE

NOTE

The foregoing statement of the Comptroller is worthy of careful consideration. It impresses the unbiased mind as a fair statement of fact and a dignified appeal for justice. Reading between the lines we find complete confirmation of all that has been said regarding the autocracy of our financial system.

The last paragraph is an appeal to our financial autocrats for justice and clemency. Such petitions were addressed, in times passed, to political rulers. Is it in keeping with American principles or ideals that we should ask the bankers to reform a practice from which

we all suffer or is it the place of a free people to reform the laws so that such abuses cannot exist?

It is not the bankers' duty but the citizen's duty to correct these abuses and the banker must not be blamed so long as he is permitted to take advantage of our neglect.

A great burden of responsibility rests on every citizen until our system of finance is reformed so that such abuses are made impossible. It is a duty which we owe to ourselves, to our country and to all humanity.

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